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Report of the Auditor General of Canada to the House of Commons

Chapter 10
Natural Resources Canada – Energy Efficiency

April 1997



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This April 1997 Report comprises 10 chapters and a Foreword and Main Points. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

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Chapter 10

Natural Resources Canada — Energy Efficiency The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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Natural Resources Canada — Energy Efficiency

Main Points

- 10.1 Natural Resources Canada (NRCan) has been in the business of promoting energy efficiency for many years. The Department has made a fundamental shift in the way it promotes energy efficiency since the mid-1980s when the emphasis was on grant programs. The Department now sees its role as providing leadership and establishing partnerships with others to reduce energy use and to improve energy efficiency. The current focus is on the environmental impacts of energy use.
- 10.2 NRCan's current set of 16 non-research and development energy efficiency initiatives is a key element supporting Canada's commitment to stabilize greenhouse gas emissions at 1990 levels by the year 2000. We found that NRCan's current performance information, on both expectations and achievements, is not sufficient to determine the overall success of its energy efficiency initiatives in terms of the contribution they are making to this stabilization goal.
- 10.3 Departmental expenditures on these 16 initiatives were about \$16.5 million in fiscal year 1995–96. Of the extensive range of policy instruments available to encourage energy efficiency, the Department uses a limited number of instruments, namely selective regulations, information and voluntary action.
- 10.4 The objectives established for many of the energy efficiency initiatives do not provide a clear and concrete expectation of achievement against which the Department can assess its progress and report to Parliament. More work must also be done to measure and assess the overall achievements of its initiatives, including the development of appropriate links to the stabilization goal. The Department is taking steps to improve the quality of its performance information, where cost-effective and feasible.
- 10.5 Opportunities exist to enhance departmental transparency and accountability by better reporting to Parliament on both the performance expectations and performance achievements of the individual initiatives.
- 10.6 The Department has begun to lay the foundation to improve the energy efficiency of its own facilities and fleet of vehicles, and it expects to achieve its current targets by the end of 1997–98.



Introduction

Background of current Efficiency and Alternative Energy Program

10.7 The Department has a long history of energy efficiency programs. Natural Resources Canada (NRCan), and its predecessor Energy, Mines and Resources, have a long history of programs to promote energy conservation, energy efficiency and alternative sources of energy. Over time, the rationale, focus and approach of such energy efficiency programs have varied greatly.

10.8 The Department initially focussed its efforts on energy conservation, which encouraged behavioural and lifestyle changes to reduce the consumption of energy. For example, people were encouraged to turn down their thermostats and to turn off unnecessary lighting. Today's focus is on improving energy efficiency by promoting a wiser use of energy without sacrificing its benefits or requiring major lifestyle changes. For example, people are encouraged to buy more energy-efficient furnaces and to buy light bulbs that produce about the same light using less energy. Exhibit 10.1 illustrates the changes in the departmental financial commitment to these types of programs over the last 20 years; the following paragraphs describe the changes that have occurred.

10.9 During the early 1970s, the Department was mainly involved in the provision of advice to ministers on energy issues, with few programs being delivered. In the mid- to late 1970s, in response to the oil crises of 1973 and 1979, steps were taken to promote energy conservation. These early initiatives were seen as a strategic response to the threat of supply disruptions, which raised concerns about

energy security. The concerns were primarily about security of oil supply, in terms of both price and availability.

10.10 Under the National Energy Program of the early 1980s, the departmental expenditures on energy efficiency programs grew significantly, as shown in Exhibit 10.1. Grant programs were used to convince energy users to become more energy-efficient.

By the mid-1980s, however, 10.11 energy prices had fallen and energy supplies were increasing. Security of supply was now seen as less urgent by the federal government and the Department. Consequently, the energy policy was changed, departmental financial resources devoted to energy conservation and alternative energy activities began to decline and the Department reduced or eliminated many of its related activities. It redirected its focus toward promoting energy efficiency through research and development, market-based research, demonstration projects and information transfer activities.

10.12 Canada's Green Plan. In the late 1980s, serious concerns began to arise about the impact on the atmosphere of certain human activities. These activities relate primarily to the use of energy that involves the combustion of fossil fuels such as oil, natural gas and coal. In particular, there was a growing worldwide concern about the burning of fossil fuels and the associated greenhouse gas emissions and their implications for global climate change. As a result of this concern and other environmental concerns, the federal government announced, in December 1990, Canada's Green Plan for a healthy environment. The Green Plan reported Canada's commitment to stabilize greenhouse gas emissions at 1990 levels by the year 2000, commonly referred to as Canada's stabilization goal.

Canada is one of the most energy-intensive countries, on both a per capita and a gross domestic product basis.

The burning of fossil fuels and the associated greenhouse gas emissions have implications for global climate change.

Canada's commitment to stabilize greenhouse gas emissions at 1990 levels by the year 2000 is commonly referred to as Canada's stabilization goal.

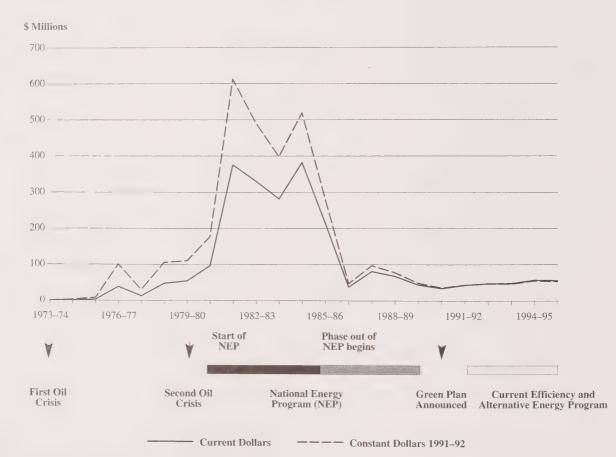
10.13 With respect to limiting greenhouse gas emissions, the Green Plan stated that the immediate emphasis must be on improving energy efficiency across a broad spectrum of uses. The Green Plan committed the federal Minister of Energy, among other things, to tabling a National Energy Efficiency and Alternative Energy Act and to improving energy efficiency in buildings, equipment, industry and transportation.

10.14 Revised efficiency and alternative energy program. In May

1991, the federal government confirmed that its initial approach to achieving the stabilization goal under the Green Plan was to focus on improving energy efficiency and to promote selected alternative energy sources. In June 1991, the Department received approval from the Treasury Board to implement a revised Efficiency and Alternative Energy (EAE) Program. The objective of the new Program was to support the Green Plan and the National Action Strategy on Global Warming, which was an approach to limiting greenhouse gas emissions.

Exhibit 10.1

Changes in Departmental Financial Commitment to Energy Efficiency Programs



Source: Departmental Main Estimates and Public Accounts 1973-74 to 1995-96

10.15 This new EAE Program includes a set of energy efficiency initiatives that collectively deal with all end-use sectors (residential, commercial, industrial and transportation) and all major fuel types. The EAE Program was expected to be carried out in co-operation with other departments and agencies of the Government of Canada, and with the provinces, municipalities, energy utilities and the private sector.

10.16 Consistent with a commitment in the Green Plan, the *Energy Efficiency Act* was tabled in Parliament in 1991, received royal assent in June 1992 and came into full force on 1 January 1993. This Act gives the Department the authority to make and enforce regulations concerning the energy efficiency of energy-using products and to promote energy efficiency and alternative energy sources.

10.17 There are 38 initiatives that make up NRCan's current EAE Program, as illustrated in Exhibit 10.2. These include initiatives related to energy efficiency, alternative transportation fuels (such as propane, natural gas, methanol and ethanol) and renewable energy sources (such as hydro, solar and wind). For 1995–96, approximately \$65 million was spent on the EAE Program. The Appendix to this chapter provides additional information on NRCan's energy efficiency initiatives, which were the focus of the audit.

10.18 United Nations Framework
Convention on Climate Change. In 1992,
Canada signed and ratified the United
Nations Framework Convention on
Climate Change, in which Canada
reconfirmed its prior commitment by
agreeing to aim to stabilize its greenhouse
gas emissions at 1990 levels by the year
2000. In response to this international
commitment, federal, provincial and
territorial ministers of energy and the

environment approved Canada's National Action Program on Climate Change (NAPCC) in February 1995. The NAPCC sets out the strategic directions Canada will follow, a key element of which is promoting greater energy efficiency in all sectors of the economy.

10.19 The Voluntary Challenge and Registry Program. One of the initiatives originally envisaged under the 1991 EAE Program was the Energy Efficiency Challenge initiative. The Climate Change Voluntary Challenge and Registry (VCR) Program, launched in early 1995 by federal, provincial and territorial energy and environment ministers, builds upon this proposed initiative as well as on federal-provincial and multi-stakeholder consultation relating to climate change. The federal government considers the VCR Program to be another key element of Canada's National Action Program on Climate Change, as do the provinces.

10.20 The Minister of Natural Resources, acting as the champion of the VCR Program, has issued a challenge to Canadian companies and organizations, including all levels of government, to develop action plans to voluntarily limit or reduce their greenhouse gas emissions. A registry currently maintained by NRCan records commitments, plans and progress.

10.21 A common goal of NRCan's energy efficiency initiatives and the VCR Program is to limit greenhouse gas emissions. Within the action plans developed for the VCR Program, the participants can use NRCan's energy efficiency initiatives and provincial and company-specific programs to reduce their energy use and their emissions of greenhouse gases. For example, the VCR Program provides opportunities for participants to apply NRCan's Industrial Energy Efficiency Initiative and the Energy Innovators Initiative as part of

A key element of
Canada's National
Action Program on
Climate Change is
promoting greater
energy efficiency in all
sectors of the
economy.

NRCan's Current Efficiency and Alternative Energy Program Initiatives

Alternative Energy: Renewable Energy Sources	. Renewable Energy Market Assessments . Information and Awareness . Energy from the Forest (ENFOR) . Renewable Energy Technologies Program		
Alternative Energy: Alternative Fuels	Propane Natural Gas Methanol Ethanol Alternative Transportation Fuels R&D		
Transportation	Motor Vehicle Fuel Efficiency Program Auto\$mart Fleet Energy Program (Fleet Wise, FleetSmart) Transportation Efficiency R&D		
Industry	Industrial Energy Efficiency Canadian Energy Management and Environmental Training Program Industry Energy R&D Industrial Targeted Technologies Advanced Technologies for Process Optimization and Control Minerals and Metals Technologies R&D Program Advanced Combustion Technologies		
Equipment	Equipment Energy Performance Regulations EnerGuide Window Labelling Heating, Ventilating and Air Conditioning Energy Energy System		
Buildings	National Energy Codes for Buildings and Houses R-2000 Home Program Home Energy Retrofit Energy Innovators Federal Industrial Buildings Energy Technology Advancement Plan: Residential Buildings Large Buildings Program Heat Management Research and Development (R&D)		
General	Consumer Information National Energy Use Database Advanced Integrated Energy Systems Technologies Technologies		

Note: Initiatives in bold type are included in the scope of this audit. See paragraph 10.31 for additional information.

their involvement in the VCR Program. The federal government's own action plan, submitted to the VCR Program in November 1995 and updated in November 1996, includes the use of two of NRCan's energy efficiency initiatives: the Federal Buildings Initiative and the Fleet Energy Program (FleetWise).

10.22 The federal role and participation in the VCR Program will be examined as part of a future audit of climate change.

Despite improvements in efficiency, energy use continues to grow

10.23 Canada is one of the most energy-intensive countries, in terms of energy use on both a per capita and a gross domestic product basis. Canada's large geographic area, long transportation distances, cold climate and resource-based economy are contributing factors.

NRCan monitors energy use in Canada, both for the country as a whole and by sector (residential, commercial, industrial, transportation and agricultural), and identifies and analyzes the trends over time. NRCan reports that, in the absence of any improvements in energy efficiency between 1990 and 1994, energy use would have grown by a total of 7.1 percent in all identified sectors. However, largely as a result of improvements in energy efficiency, energy use increased by only about 5.5 percent during that period. Therefore, while actual energy use continues to grow, it is growing at a lower rate.

10.25 NRCan's data show that, over the years, energy efficiency improvements have been realized in the residential, commercial, industrial and transportation sectors. Contributing factors could include the energy efficiency initiatives of the federal and provincial governments, energy utilities and municipalities;

improvements in production processes; and global competition. Nevertheless, while improvements in energy efficiency have helped to offset the increase in energy use, they have not been sufficient to halt its growth overall. Moreover, the Department expects that energy use will continue to respond to the growth in energy-using equipment and in the Canadian population and the economy.

Energy policy framework

A shared federal-provincial responsibility. Jurisdiction over energy policy is divided between the federal and provincial governments. The provinces own energy resources, and develop energy policies and regulations associated with the management of those resources. Federal powers are primarily associated with interprovincial and international movement of energy and energy-using equipment, and with projects extending beyond a province's boundaries. The federal government also has broad taxation and spending powers. The federal responsibility for energy policy and programs rests mainly with NRCan. Given this jurisdictional division of powers, energy efficiency programs in Canada are a shared responsibility between the federal and provincial levels of government.

10.27 Objectives of federal energy policy. The main objectives of the current federal energy policy are to ensure that:

- Canadians have secure, reliable access to competitively priced energy supplies;
- the development of Canadian energy resources and associated technology offers the maximum economic benefit to Canadians; and
- Canada's energy needs are met and that energy production and consumption are environmentally responsible.

10.28 A comprehensive review of federal government activities in 1994

While actual energy use continues to grow, it is growing at a lower rate.

NRCan believes that energy efficiency has potential for making a contribution to Canada's short-term stabilization goal. (Program Review) reconfirmed the importance of NRCan programs that support energy efficiency as well as alternative energy. The 1995 federal Budget and the 1995 Guide to Green Government state that NRCan will reorient energy policy from a focus on increasing traditional sources of supply to an increased emphasis on energy efficiency, alternative and renewable energy sources, the environment and sustainable development.

10.29 Objectives of NRCan's
Efficiency and Alternative Energy
Program. The main objective of the
current EAE Program is to ensure
environmental responsibility through
limiting greenhouse gas emissions and
helping to deal with air pollution issues.
Two secondary objectives of the program
are related to economic and industrial
development and to strengthening
Canada's science and technology base.

10.30 NRCan believes that energy efficiency has potential for making a contribution to Canada's short-term stabilization goal. According to the Department, renewable energy sources are not likely to play a significant role in reducing greenhouse gas emissions until after the year 2000. The Department also believes that there is limited short-term prospect for substituting fossil fuels with alternative fuels. Therefore, in the short term, NRCan's primary approach to limiting emissions resulting from the consumption of fossil fuels has been to reduce the use of energy and to improve energy efficiency.

Focus of this audit

10.31 Of the 38 initiatives in NRCan's current EAE Program, we focussed this audit on the overall set of 16 non-research and development energy efficiency initiatives highlighted in Exhibit 10.2, all

of which have short-term potential for reducing the use of energy and improving energy efficiency. Two of these 16 initiatives, Consumer Information and National Energy Use Database, distribute and collect information to support the EAE Program as a whole. Only two initiatives, Equipment Energy Performance Regulations and EnerGuide, are regulatory in nature. The remaining 12 energy efficiency initiatives rely on the willingness of others to take voluntary action to reduce their own use of energy and improve energy efficiency. Total departmental expenditures on the 16 energy efficiency initiatives covered by this audit were about \$16.5 million in fiscal year 1995-96.

10.32 The objectives of our audit were to assess how NRCan determines the continued relevance of its energy efficiency initiatives, to determine whether NRCan is measuring and reporting the performance of these initiatives, and to assess the extent to which NRCan has adopted and implemented energy efficiency measures within its own operations. Further details can be found at the end of the chapter in the section About the Audit.

10.33 We expect to audit NRCan's initiatives related to alternative transportation fuels and renewable energy sources at a later date. A future audit of climate change will address other federal efforts directed toward meeting Canada's stabilization goal.

Observations and Recommendations

NRCan Uses a Limited Number of Policy Instruments

10.34 Compared with the 1970s and early 1980s, there has been a fundamental

shift in the way the federal government promotes energy efficiency. This shift has been driven by such factors as decreasing federal resources, and reduced concern about oil security. Today, the federal government, and in particular NRCan, addresses energy efficiency by:

- using regulations, very selectively, to eliminate less energy-efficient products from the marketplace;
 - educating users and consumers;
- conducting voluntary programs with companies, associations, institutions and other levels of government, including forming partnerships to promote and co-ordinate energy efficiency efforts;
- supporting research and development to develop technologies that increase energy efficiency;
- working with partners to get energy-efficient technologies into the marketplace; and
- refocusing efforts in federal priority areas such as promoting sustainable development, international competitiveness and environmental stewardship.
- The federal government has an 10.35 extensive range of other policy instruments that it could use to meet its policy objectives, such as taxes, charges and subsidies. However, at this time the government has ruled out certain policy measures, such as a carbon tax on fossil fuels, as a means of causing improvement to Canada's energy efficiency and reducing greenhouse gas emissions. Also, given the federal government's current fiscal restraint, fewer resources are available for major programs such as those similar to the grant and contribution programs of the early 1980s. In addition, there has recently been a general reluctance by the federal government to

make extensive use of regulations as a major policy tool.

In this context, NRCan has used its regulatory powers very selectively, in conjunction with a limited number of policy instruments promoting energy efficiency. The Department views its role as that of serving as a catalyst and providing leadership to others to implement energy efficiency improvements. It attempts to leverage its resources through emphasis on targeted information programs, persuasion and working with others in partnerships to promote voluntary action. The current energy efficiency initiatives are expected to encourage the identification and adoption of measures that are economical and worthwhile in their own right.

10.37 NRCan has developed partnerships with provincial and territorial governments, municipalities, energy utilities, goods-producing industries, the commercial sector, and non-government organizations. For example, energy efficiency improvements are being encouraged through voluntary industrial programs. The Canadian Industry Program for Energy Conservation (CIPEC), established in 1975, sets voluntary energy efficiency targets in a range of industries. The program includes 33 trade and/or company associations and over 3,000 firms that account for about 90 percent of Canada's industrial energy use (or about 20 percent of Canada's consumption of energy).

10.38 Challenges also exist in getting consumers to implement energy efficiency improvements. Factors that impact on the adoption of energy efficiency measures include low consumer energy prices, incomplete data on how energy is used in Canada, lack of consumer knowledge about what can be done to use energy more efficiently, and the low priority that

There has been a fundamental shift in the way the federal government promotes energy efficiency.

NRCan has adjusted its energy efficiency initiatives in response to changes in the operating environment.

energy users sometimes place on energy efficiency. Although some of these factors can be addressed entirely by the Department or the federal government through the choice of policy instruments, others cannot.

10.39 The Department's current focus is on encouraging a wiser use of energy, without sacrificing the benefits provided in terms of service or comfort.

Energy Efficiency Initiatives Have Evolved

10.40 We assessed actions taken by the Department over time to ensure that its energy efficiency initiatives continue to be relevant. We found that NRCan has adjusted its energy efficiency initiatives in response to changes in the operating environment. In doing so, it has incorporated and built upon the

experience gained in delivering previous initiatives.

efficiency initiatives, five predate the 1991 revision of the Efficiency and Alternative Energy (EAE) Program. These five initiatives are National Energy Codes for Buildings and Houses, the R–2000 Home Program, EnerGuide, Consumer Information and Motor Vehicle Fuel Efficiency Program. Exhibits 10.3 and 10.4 illustrate the evolution of two of these five initiatives.

efficiency initiatives, some are in fact spinoffs of other initiatives. For example, since 1978 NRCan has been involved in administering an EnerGuide labelling program for energy-using equipment as required by the regulatory authority of another federal department. Under the 1992 Energy Efficiency Act, the statutory

Exhibit 10.3

Evolution of the National Energy Codes for Buildings and Houses Initiative

Period	Nature of Departmental Activity Measures for Energy Conservation in New Buildings were published.			
1978				
1983	Measures for Energy Conservation in New Buildings were revised. These were promoted as voluntary measures to be used in conjunction with the National Building Code of Canada.			
1990–96	The Department co-funded research to develop National Energy Codes for buildings and houses and to develop compliance software and field guides for applying these Codes.			
1990	The National Research Council commenced development of new National Energy Codes (buildings and houses), in conjunction with the Department, provincial and territorial governments and utilities. The new Codes were designed to be economically justifiable and sensitive to variations in factors such as regional construction requirements, cost of materials, and energy prices. Another criterion was to provide flexibility in how they are implemented.			
1994–95	Drafts of National Energy Codes (buildings and houses) were released for public review.			
1995	The Department began supporting the development of implementation tools such as computer programs and training, in conjunction with its partners.			
1997	The final version of the National Energy Codes is expected to be published. [Note: The regulation of buildings and houses in Canada is the responsibility of provincial and territorial governments. Neither of these Energy Codes becomes law until adopted by the responsible jurisdictions.]			

authority for the EnerGuide labelling initiative was transferred to NRCan. The current EnerGuide initiative is a mandatory program that requires manufacturers to affix labels to eight types of major household appliances to provide information to consumers about the products' energy consumption. The 1994 Window Labelling initiative and the 1996 Heating, Ventilating and Air Conditioning (HVAC) Energy Efficiency Rating System initiative are both voluntary labelling initiatives. They have built upon the concepts of the EnerGuide initiative and expanded them to other products.

10.43 The Home Energy Retrofit initiative, which started in 1993, promotes the use of technologies and building products developed under the R–2000 Home Program. While the R–2000 Program focusses on making energy improvements in the construction of new houses certified to the R–2000 standard, Home Energy Retrofit focusses on improving the energy efficiency of the more than seven million existing houses and other low-rise residences in Canada. The Department estimates that the owners of many older homes could save up to 25

Period	Nature of Departmental Activity			
Late 1970s	Work began under the Super Energy Efficient Home Program to carry out research and development (R&D) on more energy-efficient homes.			
Early 1980 s	The R-2000 Home Program was launched to spur improvement in Canadian residential housing, with the Department demonstrating what could be achieved with the best available technology, building practices and material The R-2000 specifications were expected to achieve savings of up to 50 percent of the energy used by conventional homes. The Department continued to fund related R&D and by the end of 1995 more than 7,000 certified R-2000 homes were built in Canada.			
1984	The R-2000 Program was formally commercialized when the Department teamed up with the Canadian Home Builders' Association (CHBA) to deliver the Program to its 12,000 member companies across Canada. Although the Department continued to fund related R&D, its focus was on the promotion of the R-2000 standards through development of training programs for builders, and through promotional literature, advertising, exhibits and formal certification of R-2000 homes.			
1991	The R-2000 Program was expanded to include new regionally based partnerships to increase market penetration.			
1994	The Department produced an upgraded standard for R-2000 construction, in consultation with home builders' associations, provincial governments and utilities. Under new technological requirements, the energy performance of the R-2000 house was to improve by 12 to 15 percent over the existing standards. In response to the demand by partners, the new standards also included environmental and health aspects.			
1996–97	The R-2000 Program includes comprehensive training and education for builders, testing and certification of homes, and promotional activities. In co-operation with the CHBA, the Department co-ordinates R&D to improve upon existing R-2000 standards. The Department's new Advanced Houses Program, part of the Buildings Energy Technology Advancement Plan — Residential Buildings initiative, is developing the next generation of improved housing technology.			

Exhibit 10.4

Evolution of the R-2000 Home Program Given NRCan's modest resources and limited policy instruments, most of the initiatives focus on providing encouragement and information to others. percent of their heating costs if they made certain affordable upgrades.

The Fleet Energy Program currently consists of two components: FleetSmart and FleetWise. A previous component, Pro-Trucker, launched in 1985 and phased out in March 1996, promoted energy-efficient driving practices to professional truckers. The two current components build upon the experience gained from Pro-Trucker in developing information products and training modules and in recruiting fleet managers to participate in the program. FleetSmart, to be formally launched in early 1997, is expected to encourage public and private sector vehicle fleet managers to adopt energy-efficient practices and to use alternative fuels. FleetWise, started in 1995, is similar to FleetSmart but directed specifically at federal vehicle fleets.

adjustments to its energy efficiency initiatives, the Department recently announced improvements to some of its existing initiatives. For example, NRCan plans to make new regulations that will cover electric motors, air conditioners, heat pumps, transformers and other products. It also plans to release a Canadian Home Energy Efficiency Rating System and develop related audit software to help home owners and others identify cost-effective opportunities for energy efficiency retrofits.

Improved Performance Information Needed

10.46 NRCan's energy efficiency initiatives were approved by the federal government to improve energy efficiency in Canada, thereby reducing greenhouse gas emissions. Given NRCan's modest resources and limited policy instruments, most of the initiatives focus on providing

encouragement and information to others to reduce energy use and to improve their energy efficiency.

10.47 It is important for the Department, as well as Parliament, to know what these initiatives have achieved over time with the available resources. We therefore expected the Department to have performance information on its Efficiency and Alternative Energy Program and its energy efficiency initiatives to ensure transparency and accountability. We use the term performance information to include both performance expectations and performance achievements. Performance expectations refer to information outlining the performance that is targeted or is expected to occur in the future; performance achievements refer to information on the performance that was actually achieved. These achievements, when compared with stated expectations, allow performance to be assessed. For a given initiative, the performance achievements can be viewed in terms of its outputs and outcomes, as shown in Exhibit 10.5.

10.48 In the Appendix to this chapter, we have summarized for each of the 16 energy efficiency initiatives the date started, purpose/objective and the departmental expenditures and major achievements over four years. These achievements are expressed primarily in terms of major products and services (outputs) delivered and, where known, outcomes from 1992–93 to 1995–96.

Many energy efficiency initiatives lack clear performance expectations

10.49 We believe that it is important for NRCan to specify, and to make clear to Parliament, what it is trying to accomplish with each of its individual energy efficiency initiatives or sets of initiatives.

This information is necessary so that the Department's progress can be assessed.

10.50 As shown in the Appendix, we found that the Department reports an objective for each of its initiatives. These objectives are consistent with the overall objective of the Efficiency and Alternative Energy Program. Each objective is clearly linked to improving energy efficiency by various means in such areas as buildings, homes, equipment and vehicles. However, while each is stated in general terms such as "to encourage" and "to increase", these terms do not provide a clear and concrete expectation of achievement. We found that, for many of the initiatives, there is a lack of reported targets in terms of outcomes against which the Department can assess its progress and report to Parliament.

10.51 As previously noted, the different energy efficiency initiatives use various policy instruments to achieve their objectives. By their nature, some initiatives lend themselves more easily to setting clear and concrete performance expectations or targets in terms of outcomes. For the regulatory initiatives, for instance, the Department does prepare estimates of expected outcomes. For example, NRCan expects the energy efficiency standards for the first 20 products under the Energy Efficiency Act to save, by the year 2020, the equivalent

of the annual space-heating requirements of 1.5 million houses.

Only two of the non-regulatory initiatives — the Industrial Energy Efficiency Initiative and the Federal Buildings Initiative — have information on expected outcomes. For example, the Industrial Energy Efficiency Initiative has set a target of an overall average of one percent annual improvement in energy efficiency per unit of output by the year 2000. However, for most non-regulatory initiatives, it is not clear what the Department's expectations are or how it intends to demonstrate the achievement of its objectives.

10.53 Natural Resources Canada should develop performance expectations in terms of clear and concrete outcomes for all its energy efficiency initiatives.

Department's response: NRCan has performance expectations for a number of its energy efficiency initiatives. For example, the Industrial Energy Innovators Initiative established and achieved performance targets for: recruiting individual companies and task forces; obtaining Innovator action plans; and meeting carbon dioxide (CO₂) reduction targets for the Canadian Industry Program for Energy Conservation. The Department will continue the further development of performance expectations for its energy efficiency initiatives. Where feasible and

publication

There is a lack of reported targets against which the Department can assess its progress and report to Parliament.

For a given initiative, such as Consumer Information, performance achievements can be viewed along a continuum as follows: intermediate long-term activity outputs outcomes outcomes **Example:** development of a publication publication used by actual energy saved publication on energy distributed consumers to make as a result of using efficiency to consumers more informed information contained in the

use

decisions on energy

Exhibit 10.5

Performance Achievements Continuum The Department needs to continue to explore cost-effective ways of improving its understanding of the outcomes of its initiatives.

cost-effective, these performance expectations will comprise program outcomes and market effects as well as program outputs.

More work needs to be done to measure and assess achievements

10.54 In addition to having clear targets, we would have expected the Department to have information on the achievements of its individual energy efficiency initiatives in terms of their outputs and their outcomes. Both targets and achievements are required to help manage these initiatives and to allow Parliament to judge how well the Department is doing against expectations.

10.55 For performance achievements, we would have expected that, as a minimum, the Department would measure what products or services (outputs) it is producing. We found that, for the most part, it is doing this, as illustrated in the Major Achievements column in the Appendix. For example, under the Heating, Ventilating and Air Conditioning (HVAC) Energy Efficiency Rating System Initiative, the Department reports that 17 HVAC manufacturers, 90 percent of all such Canadian manufacturers, have joined this voluntary labelling program. This level of representation provides a good example of the extent to which the Department has been successful in building partnerships with industry to promote energy efficiency.

10.56 However, the Department does not have many outcome measurements for its energy efficiency initiatives. For example, it does not always have information on the use made of its approximately 1.5 million copies of publications distributed annually to consumers. Also missing is information on the use made of the advice provided to approximately 40,000 callers to its 1–800

consumer information lines from October 1994 to December 1996. Such information could help the Department assess the value added by its consumer information products, whether they are adequately reaching the targeted audiences and what improvements, if any, could be made to ensure that consumers are properly informed.

10.57 Ideally, the Department would need to know the extent to which its publications or other advice have influenced consumers' decisions affecting energy use, as well as the energy savings that result. We recognize that measuring these intermediate and long-term outcomes is inherently difficult, and can be costly. The outcomes are also difficult to attribute to the Department's initiatives in view of all the other influences that apply. Although the ideal may not be attainable, we believe that the Department needs to continue to explore cost-effective ways of using existing information or developing new sources of information to improve its understanding of the outcomes of its initiatives.

10.58 We found that NRCan is already taking steps to improve the quality of its performance information. To move along the continuum toward improved performance achievements (Exhibit 10.5), the Department recognizes that more work must be done to measure and assess the achievements of its energy efficiency initiatives, including:

- more use of performance measures based on outcomes, where cost-effective and feasible; and
- improved periodic evaluation of the achievements of energy efficiency initiatives.
- 10.59 In addition, NRCan is focusing on gathering additional data and information to increase its understanding of the outcomes of its energy efficiency

initiatives. Much of this work is being carried out through its National Energy Use Database (NEUD) initiative.

10.60 Natural Resources Canada should continue its efforts to improve its performance information on the achievement of individual energy efficiency initiatives, where cost-effective and feasible.

Department's response: The Department will continue its efforts to improve the performance information on the achievements of each energy efficiency initiative, where cost-effective and feasible.

NRCan's energy efficiency initiatives are not clearly linked to Canada's stabilization goal

10.61 Two logical and related questions to ask are: What is the Efficiency and Alternative Energy (EAE) Program expected to achieve overall and what contribution is expected from the Department's set of energy efficiency initiatives?

10.62 At the time the EAE Program was established in 1991, the Department estimated that the Program as a whole, including alternative transportation fuels and renewable energy sources, would contribute 30 percent or more to Canada's achieving its stabilization goal by the year 2000. This estimate was based on a number of assumptions and was dependent, in part, upon the willing and active co-operation of all sectors of the economy and all levels of government. The estimate also served to indicate that the EAE Program alone would not be sufficient to enable Canada to fully meet its stabilization goal, but that it could contribute about 30 percent of the results needed.

10.63 In March 1992, during the House of Commons Legislative Committee hearings on the bill that ultimately resulted in the *Energy Efficiency Act*, the then Minister of Energy, Mines and Resources acknowledged that this estimate was only a "ballpark figure". The Minister also stated that he did not want to be held to it. The estimate was offered in response to a question on the overall impact of the EAE Program.

10.64 In September 1993, the Department revised its estimate of the outcome of the EAE Program. The revised estimate indicated that, by the year 2000, the Program would contribute only about 20 percent of the stabilization goal, not 30 percent. The Department stated that this reduced expectation for the Program's outcome was partly a reflection of budget cuts. It also reflected changes in forecast assumptions as well as a clearer understanding of the nature of the EAE initiatives and the likely response from partners and the public. This lower estimate was not disclosed to Parliament by the Department. Moreover, the 20 percent estimate has not been reviewed in light of more recent reductions in energy efficiency programs of provincial governments and energy utilities.

10.65 The Department has not attempted to identify what portion of the projected impact of its EAE Program could be attributed to its set of energy efficiency initiatives, as distinct from its alternative transportation fuels and renewable energy initiatives. However, given the Department's position that increased energy efficiency has the greatest potential for contributing to the short-term stabilization goal, it would be reasonable to assume that a significant portion of the estimate would have to be achieved through the energy efficiency initiatives.

Additional information would help decision makers in judging whether the energy efficiency initiatives are successful.

The Energy Efficiency
Branch has identified a
number of
opportunities to
improve the
management of the
energy efficiency
initiatives and their
effectiveness.

We asked the Department if it is 10.66 able to assess the outcome of its set of energy efficiency initiatives, and thus to make a rational case for the extent of its contribution to improving energy efficiency in Canada and to achieving the overall expectation for the EAE Program. As previously noted, we found that the Department has information on the trends in energy use and on some of the achievements of the individual energy efficiency initiatives, as illustrated in the Appendix. It estimates the impact of all energy efficiency and alternative energy measures in Canada on reducing energy use and limiting greenhouse gas emissions. The Department states that it has avoided preparing estimates of the outcome of its initiatives separately from the initiatives of others because the assumptions would be arbitrary.

difficult for the Department to link the overall outcome of its energy efficiency initiatives to the overall expectations for the EAE Program in quantitative terms. As previously noted, the cost and feasibility of gathering the data must be considered. Quantification of the outcomes of the various initiatives requires additional information on effectiveness, some of which could be obtained from client and data surveys. The Department is working to improve this type of information.

10.68 Nevertheless, we believe that it is important to provide Parliament with qualitative information on the aggregate contribution of its energy efficiency initiatives to the overall expectations of the EAE Program. Such information could address NRCan's role as a catalyst, the development and maintenance of partnerships, and the maintenance of a presence in all end-use sectors. Additional quantitative information, where

cost-effective and feasible to gather, as well as qualitative information would help decision makers in judging whether the energy efficiency initiatives are successful and to what extent these initiatives can be relied upon to contribute to Canada's stabilization goal.

10.69 Natural Resources Canada should expand, where cost-effective and feasible, the information it provides on the nature and extent of the contribution being made by its set of energy efficiency initiatives to Canada's stabilization goal.

Department's response: In 1994 and again in 1996, the Department forecast the combined impact of its efficiency and alternative energy measures and those of other jurisdictions on Canadian greenhouse gas emissions. In 1996, the Department released Energy Efficiency Trends in Canada, which identified and analyzed the factors that caused changes in energy demands and, hence, emissions between 1990 and 1994. The Department will continue to expand its efforts to assess the contribution made by its set of energy efficiency initiatives to Canada's stabilization goal, bearing in mind the difficulties of measuring and attributing the extent of changes in greenhouse gas emissions to individual initiatives.

Improved performance information will improve planning

- **10.70** Improved performance information on the Department's energy efficiency initiatives can contribute to improved planning by:
- identifying and overcoming factors impacting on adoption of energy efficiency measures;
- determining the optimum level of effort to be applied to each sector and to each initiative;
- identifying opportunities to refocus and consolidate existing initiatives;

- continuing to adapt the current programs to meet changing needs; and
- continuing to explore potential new initiatives by building on prior expertise and knowledge gained.
- efficiency initiatives are delivered by the Energy Efficiency Branch. As part of a government-wide requirement, NRCan developed its first formal business plan for the Branch for the 1996–97 fiscal year. This business plan sets out certain general strategic directions for the Branch. To support this plan, NRCan developed more detailed plans related to each of its energy efficiency initiatives or set of initiatives.
- The Branch has identified a number of opportunities to improve the management of the initiatives and their effectiveness. In addition, it has identified new initiatives that could be implemented as circumstances change. More recently, in June 1996, NRCan entered into a contract with a consultant to provide the Department with advice on delivery of current energy efficiency initiatives. The contractor submitted a report with findings and recommendations in January 1997. Advice was provided to the Department on the strengths, weaknesses and opportunities for significant changes to or extensions of the delivery of these initiatives, within the existing budget and framework.
- 10.73 We found that NRCan is taking steps in the right direction to improve internal management of its energy efficiency initiatives through enhanced business planning.

Reporting to Parliament needs to be improved

10.74 A number of reports are available to parliamentarians that contain performance information related to

NRCan's energy efficiency initiatives or to the Efficiency and Alternative Energy Program as a whole. In 1996, as part of the federal government's Improved Reporting to Parliament Project, the Department tabled a revised Part III of the Estimates early in the year and a new Performance Report in the fall. Also, as required under the 1992 Act, the Department produces an annual Report to Parliament on the Administration and Enforcement of the *Energy Efficiency Act*. In addition, two new reports were prepared and released to the public in 1996: Energy Efficiency Trends in Canada: Energy Efficiency Indicators; and Influencing Energy Use in Canada: Progress Indicators on Initiatives Delivered by Natural Resources Canada.

- 10.75 These reports generally provide performance information on the achievements of an initiative, such as the number of home builders trained in a given period. However, they typically lack performance expectations in terms of outcomes, such as how many home builders the Department expected to train or how many builders could have been trained in that same period. This makes it difficult for the reader to judge the success of the initiative.
- 10.76 Important information is also missing about the environment in which these initiatives are being delivered, the risks and challenges the Department faces, and the underlying assumptions being made. For example, some key assumptions relate to the world oil price, the growth in the Canadian economy, and the level of funding provided to energy efficiency programs by provincial governments and utilities. Such information would help the reader understand the context associated with delivering these initiatives.

Improvements in reporting performance information would improve transparency and enhance accountability.

10.77 In addition, all of these reports are silent on the original or revised estimate of the contribution these initiatives could make toward Canada's stabilization goal as well as the contribution actually being made. Moreover, the various reports provide different types of performance information. Depending on the date of the report and the nature of the target audience, the information is expressed using different units of measurement, different baselines and different reporting timeframes. In these circumstances, it is difficult for the reader to consolidate the information to determine exactly what the Department has achieved and its contribution to Canada's stabilization goal.

10.78 In its annual Report to Parliament on the Administration and Enforcement of the Energy Efficiency Act, NRCan reports the achievements of each of its energy efficiency initiatives on a fiscal year basis and provides summary information on energy use in Canada. However, the report does not make any link between achievements of individual initiatives and improvements to energy efficiency in Canada. Without good performance information, we believe Parliament will find it difficult to judge the success of the energy efficiency initiatives in aggregate terms.

10.79 NRCan's report titled Influencing Energy Use in Canada provides more complete information on progress being made by each of the energy efficiency initiatives. In that report, the Department has begun to use a "report card" format that provides a mix of performance information on activities, outputs and, in some cases, outcomes. Exhibit 10.6 provides one example of this type of reporting. In our opinion, this new format represents an improvement over previous

reporting formats by showing progress over time and, in some cases, by identifying future expectations. However, where possible, more quantitative information needs to be incorporated in the "report cards".

10.80 The Department has recognized the need to assess how best to incorporate this improved information into its annual Report to Parliament on the *Energy Efficiency Act*. NRCan is in transition and is beginning to change to results-based management. It acknowledges that, for the energy efficiency initiatives, it is not in a position to compare planned results or achievements with actual achievements to the extent that it would like to.

10.81 Improvements in reporting performance expectations and performance achievements would improve transparency and enhance the Department's accountability to Parliament for its energy efficiency initiatives.

10.82 Natural Resources Canada should enhance its reporting to Parliament by consolidating and incorporating improved performance information and by stating any important challenges and underlying assumptions.

Department's response: Beginning with its 1996–97 Report to Parliament on the Energy Efficiency Act, NRCan will incorporate the type of improved performance information set out in its two new publications (Influencing Energy Use in Canada: Progress Indicators on Initiatives Delivered by Natural Resources Canada; and Energy Efficiency Trends in Canada: Energy Efficiency Indicators). As the Department pursues improvements in measuring program performance, this additional information also will be incorporated into: the annual Report to Parliament on the Energy Efficiency Act;

the Main Estimates; and the Department's Annual Performance Report.

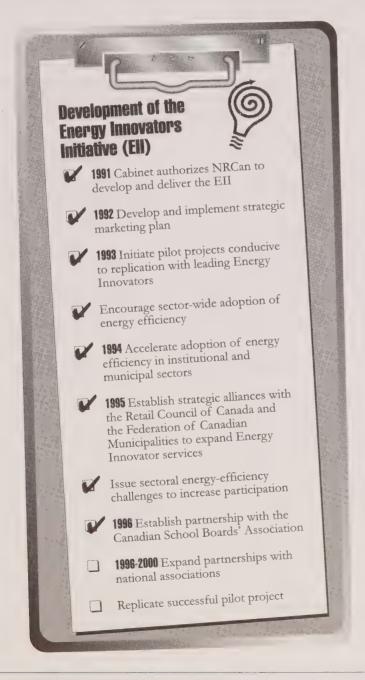
Foundation Laid to Improve Departmental Energy Efficiency

10.83 In November 1994, the Minister of Natural Resources committed NRCan to becoming the most energy-efficient

department in the federal government. This commitment was reaffirmed in NRCan's 1996–97 Part III of the Estimates, which states: "NRCan will work to make its facilities the most energy-efficient in the federal government through the Federal Buildings Initiative, and will develop an aggressive Fleet Management Program to reduce costs and

Exhibit 10.6

Report Card of the Energy Innovators Initiative



Source: NRCan

The Minister of Natural Resources committed NRCan to becoming the most energy-efficient department in the federal government.

showcase alternative transportation fuels." The Department has begun implementing the Federal Buildings Initiative and FleetWise in its own operations.

10.84 One of the targets that the Department established was to reduce its annual energy bill for its facilities by more than 18 percent over 1993-94 levels by the end of the 1997-98 fiscal year. The Department estimates that this will result in energy savings of \$680,000 per year. Under the Federal Buildings Initiative, the Department obtained approval in September 1994 to enter into a contract for the management and implementation of energy efficiency improvements for the Geological Survey of Canada facility located in Calgary. This project, completed in February 1996, is expected to provide average annual energy savings of about \$63,000 per year. In June 1996, the Department signed a contract for its more than 300 other buildings and facilities. The Department stated that at 31 December 1996, approximately 60 percent of the Federal Buildings Initiative energy efficiency improvements had been implemented. The Department expects all improvements to be completed by the end of June 1997 and to meet its energy savings target by 31 March 1998.

10.85 While the Department has set a monetary target to reduce its annual energy bill, this target could be achieved without any energy efficiency improvements if energy prices were to decline by an equivalent amount. Alternatively, if energy prices were to rise, the Department could find it more difficult than expected to achieve its target. However, the Department has expressed this target in units of energy and water consumption and has informed us that these latter targets will be disclosed to Parliament in future Part IIIs of the Estimates and in future departmental

Performance Reports. We believe that such disclosure, and reporting achievements against targets expressed in units of energy and water consumption, would enable a better assessment of the success of meeting the target through energy efficiency improvements.

- 10.86 The new Fleet Management Program covers an initial three-year period from 1 April 1995 to 31 March 1998. It intends to address NRCan's commitments through the following actions:
- reducing the fleet size by 40 percent (from 700 to 420 vehicles) and expanding the use of vehicle pooling;
- improving energy efficiency by increasing driver education, implementing route planning, enhancing vehicle maintenance practices and installing on-board vehicle computer systems to monitor driving practices; and
- advancing the use of alternative fuels through the replacement and conversion of all its vehicles to alternative fuels where cost-effective and operationally feasible.
- 10.87 At the time of our audit, progress had been made on what NRCan considers to be the most important initiatives within its Fleet Management Program, that is, fleet reduction, vehicle pooling and alternative fuels conversion. The Department has informed us that, as at 31 January 1997, its fleet size had been reduced to 532 vehicles. It expects to reach its interim target of 516 vehicles by 31 March 1997 and its target of 420 vehicles by 31 March 1998.
- 10.88 In April 1996, the Department began a one-year pilot project at its headquarters complex, which consists of pooling 27 vehicles. The Department plans to evaluate the results of this project in March 1997 to decide whether the project will be extended and expanded.

10.89 The Department informed us that, between 1 April 1995 and 31 January 1997, it converted 35 existing vehicles to alternative fuels and purchased four vehicles that were manufactured with alternative fuel systems. The Department plans to continue converting its existing vehicles and purchasing new vehicles that run on alternative fuel whenever cost-effective and operationally feasible.

10.90 Other actions have begun or are planned on additional energy efficiency aspects of the Fleet Program. A departmental policy on fleet management has been approved and is expected to be distributed in March 1997. A transportation handbook incorporating "green" (energy-efficient and environmentally friendly) driving practices, currently in draft form, is expected to be distributed to all departmental employees by April 1997. To increase driver education, the Department is exploring the possibility of incorporating "green" driving practices as part of an existing departmental course on defensive driving, with a start-up date prior to 31 March 1998. Within the context of its vehicle-pooling project, the Department expects to begin implementing its route-planning software in June 1997, to test on-board vehicle computer systems on three vehicles in the summer of 1997 and to test its enhanced vehicle maintenance practices as opportunities arise.

10.91 Although the Department did not have the necessary information system in place prior to the commencement of the Fleet Management Program, it has developed baseline data for the fuel consumption of its fleet for the first year of the Program. These data could provide a basis for measuring the Department's future progress on energy efficiency in the transportation area.

10.92 As a result of federal government downsizing measures, NRCan is in the process of reducing its financial, physical and human resources. For the Federal Buildings Initiative, the Department has included clauses in its contracts to adjust the baseline data to take into account external influences, including reductions due to departmental downsizing. This could assist the Department in considering these reductions when reporting on the achievements of its own energy efficiency efforts for its buildings and facilities. To ensure fair and proper reporting of the achievements of its energy efficiency efforts in the transportation area, as distinct from reductions in energy consumption brought about by downsizing, the Department needs to examine ways to separate the impacts of downsizing from other measures it is taking to reduce energy use.

10.93 In our opinion, NRCan has begun to lay the foundation to improve its own energy efficiency. While additional achievements are required in certain areas, the Department expects to meet its commitments or targets by 1997–98.

While additional achievements are required in certain areas, the Department expects to meet its commitments or targets for its own operations by 1997–98.

Conclusion

10.94 NRCan has been in the business of promoting energy efficiency for many years. However, the policy drivers, delivery mechanisms and resources have changed significantly over time. The focus has moved from an initial concern about security of supply to a concern about the environmental impacts of energy use.

10.95 The Department has made a fundamental shift in the way it promotes energy efficiency. Today it places heavy reliance on voluntary measures, with only selective use of regulations. It acts as a catalyst, and attempts to leverage its limited resources by using partnerships to

The current performance information is not sufficient to determine the overall success of the initiatives.

encourage others to use energy more efficiently. For the most part, the departmental role is to provide federal leadership to others to implement energy efficiency improvements in Canada.

10.96 Improving energy efficiency is a key element in enabling the federal government to achieve its commitment to stabilize greenhouse gas emissions at 1990 levels by the year 2000. This is a major commitment to which NRCan is expected to make a significant contribution.

10.97 Information is not available on the contribution that is being made, or that could be made, to Canada's stabilization goal by the set of energy efficiency initiatives. We found that the current performance information is not sufficient to determine the overall success of the initiatives in contributing to this goal. The Department needs to develop appropriate links between the outcome of its energy

efficiency initiatives and the stabilization goal.

10.98 Our audit also identified the need for improved performance information pertaining to the individual energy efficiency initiatives, where cost-effective and feasible. In addition, there are opportunities to enhance the transparency of the energy efficiency initiatives and departmental accountability, by better reporting to Parliament on expectations and achievements.

10.99 In November 1994, the Department committed itself to becoming the most energy-efficient department in the federal government. The Department has made progress over the last two years toward improving its energy efficiency and expects to meet its targets by 1997–98.



About the Audit

Objectives

Our audit objectives were:

- to assess whether the purposes of NRCan's energy efficiency initiatives are in line with current government policy and departmental objectives, and how NRCan determines their continued relevance:
- to determine whether NRCan is measuring and reporting the performance of the energy efficiency initiatives; and
- to assess the extent to which NRCan has adopted and implemented energy efficiency measures within its own operations.

Scope

Our audit focussed on the set of 16 energy efficiency initiatives of NRCan's Efficiency and Alternative Energy (EAE) Program that are not related to research and development.

The quantitative information in this chapter has been drawn from the various government sources indicated in the text. Although this quantitative information has been checked for reasonableness, it has not been audited unless otherwise indicated.

The other initiatives of NRCan's EAE Program related to alternative transportation fuels and renewable energy sources are expected to be covered in separate audits at a later date.

Audit Team

Ian Campbell Robert Pelland Jerry Rosinski Mary Louise Sutherland

For information, please contact Ellen Shillabeer, the responsible auditor.

Appendix

Energy Efficiency Initiatives — Purpose/Objective, Departmental Expenditures and Major Achievements (1992–93 to 1995–96)

General Programs

The general programs provide support to all the other initiatives by collecting and analyzing data and distributing information.

Initiative	Purpose/Objective	Departmental Expenditures 1992–93 to 1995–96 (Note 1)	Major Achievements 1992–93 to 1995–96
Consumer Information (started 1970s)	To increase Canadians' awareness of the environmental effect of energy use and to encourage energy-efficient practices and the use of alternative energy sources	\$5.1 million	 distributed each year approximately 1.5 million copies of over 300 Efficiency and Alternative Energy publications provided a broad range of marketing activities including publications, exhibits, magazine articles, animated public service announcements and calendars provided newspaper supplements on energy efficiency to 3.8 million households
National Energy Use Database (NEUD) (started 1991)	To give decision makers the information on secondary energy consumption in Canada that they need to assess progress in improving energy efficiency and to analyze opportunities for further improvement	\$6.8 million	 funded several surveys, such as: Survey of Household Energy Use, 1993 Survey of Canadian New Household Equipment Purchases, 1994 and 1995 Survey of Houses Built in Canada, 1994 Home Energy Retrofit Survey, 1994 and 1995 National Private Vehicle Use Survey, 1994, 1995 and 1996 Industrial Consumption of Energy Survey, 1994 and 1995 established five data and analysis centres in universities across Canada, with each centre focussing on a different sector of the Canadian economy (i.e. residential, industrial, commercial, agricultural and road transportation for private vehicles)

Energy Efficiency – Buildings

These initiatives focus on improving energy efficiency in existing and new homes and buildings.

Initiative	Purpose/Objective	Departmental Expenditures 1992–93 to 1995–96 (Note 1)	Major Achievements 1992–93 to 1995–96	
Federal Buildings Initiative (FBI) (started 1991)	To encourage comprehensive energy efficiency upgrades and retrofits in federal government facilities	\$2.8 million	 provided a full package of products and services to federal departments and agencies including financing arrangements and a list of qualified contractors assisted all federal custodial departments (11) in setting up 35 energy efficiency contracts, which are at the preliminary engineering, tendering or implementation phases established strategic alliances with energy utilities and industry associations to promote the Federal Buildings Initiative (FBI) with their members obtained private sector commitment as of March 1996 to invest \$120 million in federal facilities that are expected to yield an estimated \$17 million in annual energy savings assisted five provincial governments, several municipalities and two Crown corporations and agencies to adopt the FBI model 	
National Energy Codes for Buildings and Houses (started 1990)	To increase the energy efficiency of new Canadian buildings by specifying minimum thermal performance levels and supporting the incorporation of these energy codes into provincial and municipal building regulations	\$3.1 million	 collaborated with the National Research Council (NRC), utilities and other levels of government to develop National Energy Codes (these are expected to be published by NRC in 1997) raised awareness of the Codes through exhibitions, presentations and conferences 	
R-2000 Home Program . (started late 1970s)	To increase the energy efficiency in new houses	\$7.6 million	 certified over 4,000 R-2000 houses, representing .68 percent of national housing starts; and over 10 percent of the starts in New Brunswick and over 4 percent in Nova Scotia for 1995–96 trained about 3,500 builders in R-2000 standard promoted the building of R-2000 houses through national and regional building associations, product manufacturers and equipment suppliers 	
Home Energy Retrofit (started 1993)	To encourage Canadians to make their homes more energy-efficient, especially when undertaking home renovation and maintenance projects	\$2.4 million	 encouraged the consideration of energy efficiency in renovations by providing information through newsletters (Retro-Vision), consumer campaigns, national marketing initiatives (Reno\$ense) and through six demonstration projects developed draft guidelines for home energy rating system 	
Energy Innovators Initiative (started 1991)	To encourage corporations, institutions and municipalities to increase the energy efficiency of their facilities	\$3.3 million	 enrolled more than 300 organizations controlling about 17 percent of Canada's total commercial floor space, to reduce their energy consumption and to increase the energy efficiency of their facilities provided information, models, training, guidebooks, project financing options, list of qualified energy service companies, workshops and databases 	

Energy Efficiency – Equipment

These regulatory and voluntary initiatives focus on improving the energy efficiency of residential and industrial products.

Initiative	Purpose/Objective	Departmental Expenditures 1992–93 to 1995–96 (Note 1)	Major Achievements 1992–93 to 1995–96
Equipment Energy Performance Regulations (first regulations came into effect in 1995)	To eliminate less efficient energy-using equipment from the Canadian market by establishing minimum energy-efficiency performance levels for equipment	\$4.3 million	 drafted Energy Efficiency Act in 1991 (came into full force in January 1993) originally regulated 20 residential products, accounting for 60 percent of residential energy demand subsequently regulated two additional products that pertain to certain types of lamps produced and distributed Guide to the Energy Efficiency Regulations, Lamp Replacement Guide and fact sheets on electric motors and lighting products implemented a compliance regime for regulated products
EnerGuide (started 1975 under Consumer and Corporate Affairs legislation; moved to NRCan legislation in 1992)	To encourage consumers to purchase energy-efficient equipment by disseminating information on the energy performance of a range of competing products	\$5.2 million	 introduced new EnerGuide label for eight types of regulated household products to indicate each product's energy consumption and relative energy efficiency published EnerGuide directory for consumers, as part of the Equipment Energy Performance Regulations issued guides to appliance industry to improve labelling practices developed training program for retail industry
Window Labelling (started 1994)	To encourage consumers to buy energy-efficient windows by informing them about the product's energy performance	(Resources included under National Energy Codes for Buildings and Houses)	 eight window manufacturers (representing 10 percent of the market) joined the voluntary labelling program consistent with EnerGuide about 65,000 certified windows and patio doors available on the market
Heating, Ventilating and Air Conditioning (HVAC) Energy Efficiency Rating System (started 1996)	To encourage consumers to buy energy-efficient furnaces and central air conditioners by informing them about the energy performance of these products	(Resources included under EnerGuide)	 17 HVAC manufacturers (representing 90 percent of all such Canadian manufacturers) joined the voluntary labelling program consistent with EnerGuide provided training materials and other products and services for dealer education programs

Energy Efficiency – Industry

These initiatives focus on assisting industry in improving energy efficiency.

Initiative	Purpose/Objective	Departmental Expenditures 1992–93 to 1995–96 (Note 1)	Major Achievements 1992–93 to 1995–96
Industrial Energy Efficiency (started 1992)	To increase energy efficiency in the manufacturing and mining sectors	\$4.7 million	established a framework consisting of an advisory council of senior industry executives, the Canadian Industry Program for Energy Conservation (CIPEC) and the Industrial Energy Innovators Initiative under this framework the following was
			accomplished: - recruited and encouraged 255 industrial energy users to develop long-term energy management planning - developed a 1990 baseline for energy use in each of the manufacturing, mining and forest products sectors - established 14 industrial sector task forces (committed to an overall average of one percent annual energy efficiency improvement per unit of output by the year 2000; 11 of the task forces have finalized their action plans) - completed six studies on sector energy efficiency potential and end use - developed a system to monitor and report on industry's progress toward its targets - recruited/encouraged 33 trade and/or company associations to become involved in the Program
Canadian Energy Management and Environmental Training (CEMET) Program (started 1992)	To provide energy users with opportunities for skills development in energy management	\$2.0 million	 operated through affiliated community colleges and other delivery agents where approximately 30 courses per year are delivered trained almost 1,000 students in a variety of energy management courses and workshops developed training courses, strategies and educational material

Energy Efficiency – Transportation

These initiatives focus on promoting the manufacture of fuel-efficient vehicles and energy-efficient practices in the purchase, operation and maintenance of vehicles.

Initiative	Purpose/Objective	Departmental Expenditures 1992–93 to 1995–96 (Note 1)	Major Achievements 1992–93 to 1995–96
Motor Vehicle Fuel Efficiency Program (formerly known as Motor Vehicle Fuel Consumption, which started in 1978, and was expanded and renamed in 1995)	To inform purchasers of new cars, light trucks and vans about the fuel efficiency of these vehicles and to encourage motor vehicle manufacturers to undertake further improvements in vehicle fuel efficiency	\$.5 million	 produced and distributed the Fuel Consumption Guide (approximately 300,000 per year) and promoted public education projects in co-operation with Transport Canada assisted manufacturers to provide fuel consumption labels for new vehicles for fuel consumption comparisons signed three Memoranda of Understanding (MOUs): one with the Motor Vehicle Manufacturers' Association in November 1995, another with the Association of International Automobile Manufacturers of Canada in February 1996, and a third with the U.S. Department of Energy on Road Transportation Energy Efficiency and Alternative Fuels in March 1996 (the MOUs with the manufacturers are expected to provide an opportunity to obtain further voluntary commitments on fuel efficiency)
Auto\$mart (started 1994)	To encourage motorists to make fuel-efficient decisions in the purchase, operation and maintenance of their vehicles	\$2.5 million	 increased awareness of transportation energy efficiency through consumer publications, advertising, driver training and joint initiatives with public and private partners distributed more than 150,000 Auto\$mart publications in 1995–96 received a total of 4,000 calls to the 1–800 information line on Auto\$mart since it was launched
Fleet Energy Program (started 1995)	To help public sector and commercial fleets reduce fuel costs and vehicle emissions through energy-efficient decisions in their fleet operations	Pro-Trucker — (started 1985) \$1.0 million FleetWise — (started in 1995) \$.2 million FleetSmart — (to be formally launched in early 1997) \$1.5 million	 provided information materials, workshops, technical demonstrations and training programs trained about 22,500 professional truckers in energy-efficient driving practices in the Pro-Trucker program signed on about 270 federal fleet managers to FleetWise (these managers are expected to cut costs, improve energy efficiency, minimize environmental effects of the more than 25,000 federal vehicles and encourage use of alternative fuels in the federal fleet) contacted about 200 private fleet managers to encourage their participation in FleetSmart when launched – to save fuel and reduce operating costs through energy efficient practices

Sources: Annual Reports to Parliament on the Administration and Enforcement of the *Energy Efficiency Act* and other departmental information.

Note 1: NRCan's partners also contribute funds to the delivery of some of the energy efficiency initiatives.

Note 2: The quantitative information in this Appendix has been checked for reasonableness.

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Report of the Auditor General of Canada to the House of Commons

Chapter 11
Moving toward Managing for Results



Report of the Auditor General of Canada to the House of Commons

Chapter 11 Moving toward Managing for Results

This October 1997 Report comprises 11 chapters and a Foreword and Main Points. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

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Moving toward Managing for Results



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Assistant Auditor General: Maria Barrados Responsible Auditor: John Mayne

Moving toward Managing for Results

Main Points

- 11.1 Meeting Canadians' expectations for cost-effective programs requires that government managers focus on achieving results, especially benefits for Canadians. Basing decisions on results is vital as government reviews its involvement in program delivery and relies more on delivery by third parties. However, we found that managing for results is not widespread in government. In the past, managers have tended to focus on the resources they used, the activities they carried out and the procedures they followed.
- 11.2 A number of recent government initiatives support a focus on results, but concerted effort is required to bring about change. This study sought to support this change by drawing together experience from Canadian government programs and some other jurisdictions that have made significant progress. We selected examples for the study that illustrate different contexts and approaches.
- 11.3 We found cases where managers were measuring performance, communicating results information internally and externally and using the information to improve results. Managers of these programs were able to point to improvements in the key outcomes that they and their ministers were trying to achieve for Canadians. They also found that managing for results improved their management practices, program activities and programs' credibility.
- 11.4 The way managing for results is implemented will vary depending upon the situation of a particular program, but we found a number of consistent themes. Senior management leadership and commitment at all levels of government are particularly important. Effective managers create an organizational climate that encourages managing for results. Also important is agreement on the results to be expected and how to measure them. Although difficult to achieve, such agreement is necessary in order to focus activities and permit an assessment of progress.
- 11.5 Continued progress in managing for results will require ongoing leadership and attention across government. In particular, decision makers need to show that results count, by asking about results and visibly using them to make decisions.



Introduction

Results Focus Is Needed

11.6 In recent surveys, Canadians have said that they want public servants to focus more on the results to be achieved than on how things get done. They also want to be better informed of the progress that is being made and what they are getting for their tax dollars. The public is challenging government to spend less, yet is not willing to give up cherished programs or accept a lower quality of service. At the same time, government has been looking for ways to reduce the deficit, control debt and keep Parliament and Canadians better informed of the results of its programs. The government has also been examining its programs to determine where its involvement is most needed and to find more cost-effective means for their delivery.

11.7 Meeting the expectations of Canadians for programs that work and finding more cost-effective means of delivering them requires managing for results. When managing for results, ministers, senior officials, managers, staff, central agencies and Parliament make decisions based on what a program is achieving for Canadians — the results that citizens value — and at what cost. In particular, there is a focus on outcomes, that is, the benefits realized. Putting this approach into practice means agreeing on expected outcomes, measuring progress toward them, using the information and reporting results.

11.8 Canadians benefit from receiving better services and programs, ministers benefit from providing better value on things that matter to the electorate, and managers and employees benefit from greater satisfaction in serving the public well.

A better balance between managing inputs and results is needed

11.9 Past emphasis on inputs and activities. Holding managers accountable for results encourages them to focus more on results. In the past, managers were primarily held accountable for the prudent use of the resources they were given, the authorities they used and the activities they carried out. The concern was to ensure that spending was within budgets and complied with established rules and regulations. This did not encourage a focus on the results produced by these resources; rather, compliance dominated managers' attention.

11.10 Probity and prudence are important elements of the government's management framework, but more emphasis on accountability for results would allow the government to reduce unnecessary rules and regulations under which managers operate. This would give them greater flexibility to respond to their unique and changing circumstances. Increased accountability for results would encourage managers to give more attention to producing benefits for Canadians. A sensible reduction in rules and regulations would empower them with the authority to do so. This should be done without sacrificing attention to essential aspects of public sector management, such as due process and fairness.

The Time Is Right

11.11 Changing to a greater emphasis on results, particularly outcomes, is not easy. Past efforts in Canada and elsewhere have been only partly successful. Incentives within government have not always rewarded a focus on results. When following proper procedures is seen as paramount, when emphasis is on new spending priorities, and/or when managers are faced with repeated new budget reductions or freezes, attention tends to be

When managing for results, ministers, senior officials, managers, staff, central agencies and Parliament make decisions based on what a program is achieving for Canadians.

focussed on resources used and activities undertaken. However, a number of recent developments in response to fiscal pressures and the public's call for greater transparency and improved service have created a more supportive climate for a results focus.

Government is committed to managing for results

11.12 In 1995, the President of the Treasury Board, in his first Annual Report to Parliament, *Strengthening Government Review*, stated:

Our government is committed to delivering programs that work for the Canadian taxpayer. To better deliver programs and services, the federal Public Service must move from a culture of rules and processes to one that also focusses on innovation and results.

11.13 The government is emphasizing the need to strengthen the capacity of departments and agencies to manage for results. An action plan for doing so has been announced and progress has been reported in the annual reports to Parliament by the President of the Treasury Board.

A number of government initiatives demonstrate and support a results focus

11.14 Program Review. The government has undertaken a fundamental review of the programs and services it provides to Canadians, rethinking what the federal government should do and how best to do it. Some programs have been ended, and delivery approaches in others have been changed and rationalized. Direct program spending has been reduced significantly, with all programs under considerable pressure to spend dollars more wisely. Managers tell us that Program Review and the related

expenditure reductions have forced them to focus on the continued value of the results they are striving to deliver to Canadians.

11.15 Better performance information for expenditure

management. As reported in Chapter 5, Reporting Performance in the Expenditure Management System, the Canadian government has recently launched several initiatives to renew the system for planning and managing expenditures and reporting on results. All these initiatives directly or indirectly demand that departments set clear performance expectations, measure and report program performance, and use that information in managing programs.

11.16 Emphasis on service quality.

Service quality is a tangible result that taxpayers have demanded and can immediately see. In 1990, with its public service renewal initiatives, the government announced its movement toward service standards, and confirmed its intentions in successive budgets. The public service Declaration of Quality Service Principles, issued in late 1995, affirmed the government's commitment to setting service standards. In September 1996, our chapter on service quality reported that implementation was slow. In response, later that year, the government publicly renewed its commitment to delivering high-quality service to Canadians. The establishment of service standards and reporting of progress toward their achievement are important dimensions of managing for results.

11.17 Alternative delivery mechanisms encourage a greater focus on results. The government's efforts to rethink the need for government intervention and to identify more cost-effective ways of delivering government programs have resulted in

approaches that give a greater degree of independence to those delivering programs and that can involve third parties, such as private organizations and other levels of government, in delivery. These arrangements raise the issue of accountability for results, which is at times reflected in legislation or formal agreements, such as the legislation for the new Canadian Food Inspection Agency, federal-provincial agreements that give provinces more responsibility for employment training, and federal-provincial agreements for the Canada Infrastructure Works program. In partnership delivery arrangements, it is essential that all parties understand and agree on what results are to be accomplished with the new delivery arrangement, and know the extent to which the results are being achieved. Focussing on results can help overcome interorganizational barriers and help identify innovative approaches.

11.18 Information technology makes managing for results more feasible.

Greater use of information technology makes it easier to collect and report on results information. Being able to easily compare information from different sources helps managers focus their activities more effectively.

Many other governments are changing to a focus on results

11.19 The Canadian government is not alone in encouraging a greater focus on results. Initiatives in other countries demonstrate that efforts to address fiscal pressures and improve service quality through managing for results are worldwide. Surveys and studies of the Organization for Economic Co-operation and Development (OECD) have noted that an orientation toward results and outcomes is evident in many OECD

countries, including Australia, Finland, Norway, Sweden and the United States.

There is enough experience to identify lessons learned and best practices

11.20 The lessons learned in past
Canadian efforts, as well as those of other
jurisdictions, can be used as a springboard
for further progress. As we observed in
our audit on reporting performance,
moving to a more results-based approach
requires education and training. In
particular, there is a need to communicate
best practices and lessons learned.
Experience in other jurisdictions and in
some Canadian government programs is
sufficient to begin an assessment of what
has been learned. This study seeks to draw
on that experience.

Focus of the Study

- 11.21 Managing for results is not widespread in government, and initiatives focussing on a more results-based approach to management are relatively recent. As a result, we concluded that a study that sought to draw together experience to date and clarify expectations would be useful at this time. The purpose of the study was:
- to propose and explain a management framework for encouraging greater progress toward managing for results:
- to identify lessons learned and best practices in moving toward managing for results; and
- to determine incentives and disincentives faced by departments and program managers in adopting a results-based management culture.
- 11.22 In this chapter, we start by setting out the framework, then discuss it in more detail, illustrating it with examples of best practices and lessons learned, and pointing out incentives and disincentives. See

 About the Study at the end of the chapter.

Efforts to address fiscal pressures and improve service quality through managing for results are worldwide.

11.23 Cases included in the study. Our study sought programs that showed some federal experience in managing for results or that were well advanced in moving in that direction. We identified four such programs. We also examined one department that had been moving in this direction for a number of years. There may be other departments and programs that could also have served as examples of progress. We did not carry out a survey across government to find these illustrative cases, but sought them out through less formal inquiry.

11.24 The four programs are:

- North American Waterfowl Management Plan (NAWMP). The Plan is intended to address the decline in population of waterfowl in North America. It is a partnership program administered jointly through the International Plan Committee (U.S./Canada/Mexico), and implemented and funded through regionally based joint ventures involving federal, state, provincial, non-governmental organizations and the private sector. From 1986 to 1996, actual contributions toward the Plan activities in Canada totalled about \$360 million, with almost half coming from the U.S. (U.S. partners contributed over \$172 million, Canadian provinces \$80 million, Canadian federal government \$59 million, private sources \$49 million).
- Canada Centre for Mineral and Energy Technology (CANMET). This federal government laboratory, part of Natural Resources Canada (NRCan), has about 700 employees and a budget of about \$90 million to conduct and sponsor research for the economical, safe and environmentally responsible recovery and use of Canada's mineral, metal and energy resources.
- Travellers Program. This program of Revenue Canada's Customs Border Services is concerned with the

international movement of people and their accompanying baggage as they enter Canada. It has almost 2,600 employees and budgeted expenditures of approximately \$113 million.

- Investigation and Control (I&C). I&C is part of Human Resources Development Canada. It employs approximately 1,100 employees and uses a budget of about \$55 million to prevent, deter and detect abuse and fraud by claimants of the Employment Insurance program. This chapter focusses on the I&C function. We did not assess the management of I&C activities bearing on other programs than Employment Insurance. Overall departmental progress in managing for results is reported in Chapter 17 — Human Resources Development Canada — A Critical Transition toward Results-Based Management.
- 11.25 We also examined one case where the whole department was moving toward managing for results.
- Department-wide accountability framework in Environment Canada. Environment Canada, with approximately 4,600 employees and expenditures of over \$546 million, has developed a framework that describes the results expected from its three business lines. The Department has put in place a number of processes for implementing the framework.
- 11.26 Finally, we also examined several cases in the United States where progress has been made in managing for results.
- 11.27 Definitions used. The results of government programs are the products and services provided by these programs and the benefits and other effects that they produce. Programs deliver two kinds of results: outputs, the direct products and services produced by government activities, such as an Employment Insurance cheque or some requested information; and outcomes, the intermediate and long-term effects of

those outputs on individual Canadians and our society.

Findings

A Framework for Managing for Results

11.28 The 1995 report to Parliament by the President of the Treasury Board states,

"the government is committed to

- defining the results it wants to achieve;
- giving managers the resources, tools, information and guidance to achieve these results; and
- measuring and demonstrating actual achievements."
- 11.29 It goes on to identify three key actions for implementing this commitment to managing for results, namely identifying visible results, improved management of results measurement and improved performance reporting. These themes were reiterated in the 1996 President's report.
- 11.30 This structure for managing for results is consistent with our review of relevant literature and experiences in other jurisdictions and in Canada. This review suggests that organizations that successfully manage for results:
- foster an organizational climate that encourages managing for results;
 - agree on expected results;
- measure actual results to improve performance; and
 - effectively report performance.
- 11.31 The last element is covered in Chapter 5, which examined reporting performance to central agencies and Parliament. This study examines the first

three elements. Exhibit 11.1 outlines the elements of the framework and the following discussion elaborates further on them

Managing for Results Has Been Beneficial

11.32 Although the ways of implementing managing for results have varied, managers, in all cases, were able to point to benefits from adopting the framework.

Programs report improved outcomes for Canadians

11.33 The key benefit of a focus on results is better results. We found that the managers of the programs we examined were able to point to improvements in key outcomes they and their ministers were trying to achieve. In addition to program performance, many factors influence changes in outcomes. It is often very difficult to separate the contribution made by a program from that of other factors. Indeed, in most of our cases, departments pointed to other factors that may also have influenced results. We consider the recognition of other contributing factors to be a good practice; however, we did not attempt to determine the relative extent to which improvements in outcomes were due to program efforts or to other factors.

11.34 As shown in the example in Exhibit 11.2, the North American Waterfowl Management Plan reported securing and enhancing a large area of waterfowl habitat and can demonstrate a related growth in waterfowl populations. Favourable weather and rainfall have also contributed. Case 1 provides additional detail on how a community of common interests supported managing for this result and on how that community manages for results.

Managers were able to point to improvements in key outcomes.

Exhibit 11.1

A Framework for Managing for Results

The purpose of managing for results is:

- to achieve effective or improved performance in terms of the intended results, especially outcomes, being achieved by a program in relation to the costs incurred; and
- based on empirical evidence, to learn about the program, its performance and the outside factors to adapt the program in light of past performance and its changing environment.

Managing for results requires:

1. Fostering an Organizational Climate That Encourages Managing for Results

Fostering an appropriate organizational climate is essential and requires:

- Demonstrating commitment and leadership. Commitment is demonstrable through such things as strong senior leadership, widely communicated mission statements, and effective guidance.
- Using external and internal levers. Interests in common with external partners, and external and internal pressures and events, are
 recognized and used to encourage a focus on results.
- Creating supporting incentives. Appropriate incentives are in place to encourage the measurement and use of performance information.
- Building expertise. Learning is supported through training, professional development and the sharing of experiences.
- Developing a capacity to learn and adapt. Learning from past experience, proactive monitoring of the environment and development
 of a capacity to cope with changing circumstances is encouraged.

2. Agreeing on Expected Results

Implementing managing for results entails agreement among program and departmental management, program staff, external partners and other key stakeholders on what outcomes the program is intended to accomplish in light of its mission and objectives, past experience and the external environment. This involves clarifying the terminology used to describe these concepts and includes the following:

- Agreeing on outcome objectives. Agreement is reached on a set of outcome objectives for the program, outlining what it is intended to accomplish in light of the organization's mission and objectives.
- Agreeing on performance indicators. Agreement is reached on a manageable set of qualitative or quantitative program performance indicators that relate to the agreed outcome objectives, and that will be used to assess and manage the program.
- Agreeing on performance expectations. Agreement is reached on a set of realistic and challenging performance expectations.
 Expectations are clear and concrete, relate to the outcome objectives and specify a time frame for their achievement.

3. Measuring Results to Improve Performance

Realizing benefits from managing for results requires:

- Measuring and reporting performance. Practices exist for collecting, assessing and reporting program performance and costs in terms of the indicators identified and agreed on.
- Using performance information. The performance information gathered and assessed is used to improve program performance.
- Reviewing and updating indicators and measures. Based on experience gained, changing circumstances and experience gained in similar programs elsewhere, the performance indicators, expectations, and measurement and communication strategies are periodically reviewed and improved.

4. Effectively Reporting Performance

Effective reporting to allow the reader to judge how well programs are doing requires:

- Describing the context and strategies used. The mission, mandate and objectives of the organization, the major strategies used and the related external context are discussed.
- Stating meaningful performance expectations. Clear and concrete key performance expectations are focussed on outcomes.
- Reporting performance accomplishments against expectations. Key accomplishments are related to expectations and are attributable, in whole or in part, to the activities undertaken.
- Demonstrating the capacity to learn and adapt. The ability of the program to learn from past performance and to adapt to external changes is demonstrated.
- Reporting fair and reliable performance information. Reported performance information is fair (understandable, relevant and balanced) and reliable (accurate).

As another example, shown in Exhibit 11.3, savings to the Employment Insurance Account generated by Investigation and Control (I&C) activities at Human Resources Development Canada have increased significantly. I&C officials attribute the increase to refocussed activities resulting from implementation of a savings performance indicator, and other factors, including increased resources, technological advances, and more severe penalties. Factors contributing to the implementation of this key indicator, and the implications for the I&C function, are described in Case 2.

11.36 As shown in Exhibit 11.4, managers of the Travellers Program reported that the percentage of travellers complying with laws and regulations on the importation of goods and the payment of taxes and duties has increased. Program officials believe that this increase comes from the use of information on results to focus activities better and from public communication of their refocussed efforts. In their view, refocussing their activities has improved compliance by making enforcement efforts more visible to travellers and by encouraging greater traveller co-operation through reducing the frustration that accompanies long wait-times at the border. Officials recognize that other factors have also played a role in increased compliance, including increased personal exemptions and declines in cross-border shopping. Case 3 describes how traveller compliance and satisfaction became issues that supported a transition to managing for results in the Travellers Program.

Progress in improving performance in other jurisdictions

11.37 Other jurisdictions that have adopted managing for results have also reported improved performance. In the United States, a 1997 General Accounting Office status report on the early stages of implementation of the Government Performance and Results Act found limited, but substantial, examples of

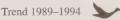
Millions 18 12 10 1985 1988 1991 1994 1982 1979

Exhibit 11.2

Total Duck Population Estimates in Southern Prairie Canada 1979-1994

Population estimate

Trend 1979-1988



Source: Prairie Habitat Joint Venture; Conserving an International Resource (North American Waterfowl Management Plan), 1986-1994, p. 8.

Other jurisdictions that have adopted managing for results have also reported improved performance.

short-term program improvements. The United States Coast Guard re-examined its mission and shifted the focus of its marine safety program from regulation to one that includes education, thereby contributing to a significant decline in the marine towing industry fatality rate. Case 4 illustrates how the United States Coast Guard manages for results, as a specific example of progress in another country.

11.38 The U.S. Veterans Health Administration reported the use of performance information to target the most important opportunities to improve health services to veterans. This practice has lowered the mortality rate for cardiac procedures by an average of 13 percent over the last eight years.

Establishing credibility

11.39 In addition to improving results, managing for results can provide a number of other benefits. One key benefit is enhanced external credibility of an organization. In 1994, CANMET reported the results of a selected sample of research and development projects in *An Investment in Canada*, which has been widely distributed inside and outside Natural Resources Canada. Its

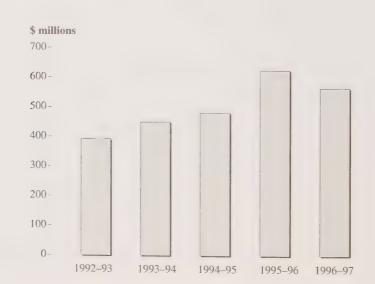
measurement of the results of research and development projects has led to external recognition in this field. Case 5 describes how managing for results was a CANMET manager's response to the need for credibility with external partners.

11.40 At Environment Canada, the development of a corporate accountability framework provides managers with the opportunity to demonstrate to others their achievements and how they contribute to meeting the Department's long-term objectives. Case 6 describes how collaborating within a corporate framework for managing for results benefits managers at Environment Canada.

Putting the Framework into Practice

11.41 Although the cases that we examined collectively exemplify the characteristics set out in the framework, none represents all of them, nor did we expect them to. There are many ways of managing for results, and it is reasonable that managers focus on those approaches that are most appropriate to their situation. Examples were chosen because they





illustrate particular points clearly or show variations in approach or context.

Fostering the right organizational climate

- 11.42 In order for benefits to be realized, the organizational culture has to support managing for results. Changing to a greater emphasis on results usually requires significant changes in the existing culture. There will likely be resistance to needed changes and thus they will take time and real effort to bring about. Experience has suggested a number of organizational factors that foster this culture:
- demonstrating commitment and leadership;
 - using external and internal levers;
 - · creating supporting incentives;
 - · building expertise; and
- developing a capacity to learn and adapt.

The stronger the presence of these factors, the greater the chance that managing for results will take hold and be effectively implemented.

- 11.43 The right climate for managing for results can be fostered at all levels of government. Credible government-wide support will encourage a focus on results, and a supportive corporate culture in a department will reinforce efforts of program managers, as in the case of Environment Canada.
- 11.44 Our study focussed mostly on the program level, where support is essential. As we noted in the Introduction, a number of initiatives, either government-wide in scope or supported by the central agencies of government, are contributing to the creation of a government-wide climate for managing for results. Exhibit 11.5 depicts the important organizational factors that encourage and support managing for results.
- 11.45 Strong senior-level leadership and continuing commitment. Managing for results takes hold when senior management visibly supports the approach and is poised to take advantage of opportunities to move toward a focus on results. Our cases and the review of experience of other jurisdictions suggests that senior management commitment and leadership is the most common and perhaps most important feature of

Changing to a greater emphasis on results usually requires significant changes in the existing culture.

Managing for results takes hold when senior management visibly supports the approach.

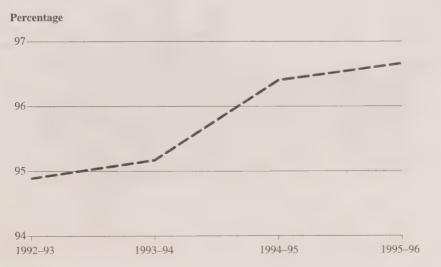


Exhibit 11.4

Percentage of Highway Travellers Complying with Rules and Regulations

Average ---

Source: Customs Border Services, Travellers Program – Year in Review: 1995–1996

Moving toward Managing for Results

Strong and persistent leadership was needed to overcome resistance.

successful managing for results. We found strong leadership shown through such actions as:

- ensuring that the organization's mission (or the program's strategic objectives) focusses on results and is accepted and communicated broadly;
- · ensuring that progress in implementing managing for results practices is a key part of performance appraisals of managers (or staff);
- supporting experimentation and innovation:
 - leading by example;
- visibly and regularly assessing progress being made toward managing for results:
- demonstrating sustained interest and personal involvement in the results management initiative;
- including performance expectations in managers' accountability accords or

performance contracts, and using these documents in the annual performance appraisals of managers; and

- entering into partnerships with other departments, governments and non-governmental organizations to pursue a common interest in results.
- 11.46 Managing for results is not without risks. In the words of the Clerk of the Privy Council, "Ministers and senior officials must accept some of the uncertainty implicit in giving up a degree of control ... [in moving] from the comfort of process to a commitment to results." Moving from the comfort of process requires considerable leadership support if managers are going to focus more on results.
- 11.47 Senior leadership was a particularly important element in our cases. A senior manager at CANMET initiated the focus on managing for results and actively sustained it over a number of years. The focus on managing for results

Exhibit 11.5

Fostering a Climate to **Encourage Managing** for Results



Executives demonstrate leadership and commitment to manage for results



Using external and internal levers



Building expertise in measuring performance



BETTER RESULTS

Capacity to adapt to a changing environment is developed



Creating incentives provides support

in the Travellers Directorate was led by the efforts of the senior managers involved. In both cases, strong and persistent leadership was needed to overcome resistance to the approach.

Using external and internal 11.48 levers. External and internal factors or events that arise can be used by committed managers as levers to encourage an organization to focus more on results. In the case of the North American Waterfowl Management Plan, a common interest in waterfowl and wetland conservation has brought a variety of parties together. It was consensus on desired results and the shared vision that allowed the Plan partnership to be formalized. At CANMET, a senior manager brought in to make the program more relevant to industry turned to managing for results as the approach.

11.49 The need to rationalize activities as part of restructuring and reorganizing can also create opportunities, although this was not the case in the Canadian programs we studied. However, to make use of the opportunities that these factors create, management has to recognize and be prepared to respond to them. The organization also needs the capacity to respond, which includes appropriate supporting incentives, expertise and adaptive capacity.

11.50 Supporting incentives.

Traditional budget-driven and process-oriented management practices may be resistant to change because of the existing incentive structure. As suggested earlier, incentives in the past have often run counter to efforts at measurement and a focus on results. In CANMET, for example, resistance was encountered due to the traditional scientific incentives based on publication frequency. As well, resistance to specific results approaches

adopted may arise from a conflict within an organization between goals, such as service and financial goals. This was the case in the Employment Insurance (EI) program at Human Resources Development Canada, where generating savings to the EI Account was not seen by some staff as consistent with working to increase the employability of clientele. Overcoming these sources of resistance requires attention to existing incentives, both tangible and intangible, and the development of incentives that support managing for results. We found that a variety of incentives can be used, including:

- ensuring that managers (or staff) are provided at least annually with an occasion to demonstrate what their programs have accomplished. For example, CANMET, Investigation and Control, and the Travellers Program use accountability accords as incentives. These agreements between levels of management specify the results to be achieved by managers over a certain time frame and are used in reviews of the manager's performance;
- providing needed management flexibility to program managers (or staff) to allow them to move toward managing for results. In CANMET, managers are given increased authority in return for being accountable through accountability accords for achieving performance expectations;
- supporting programs that supply good performance information. The Treasury Board Secretariat has supported Investigation and Control efforts to generate savings to the Employment Insurance Account by allocating resources tied to performance targets; and
- encouraging the development of intangible incentives in the organization (or program), such as recognition or rewards for managing for results.

Overcoming resistance requires attention to incentives.

CASE 1: MANAGING FOR RESULTS IN THE NORTH AMERICAN WATERFOWL MANAGEMENT PLAN (NAWMP)

he North American Waterfowl Management Plan (NAWMP) is an international waterfowl and wetlands conservation program designed to restore waterfowl populations through securing, enhancing, and managing wetlands and uplands habitat. Signed by Canada and the United States in 1986, it established a 15-year framework for international co-operation for the preservation of migratory birds. In 1994, the Plan was reviewed and the original commitment expanded in the 1994 Update to the North American Waterfowl Management Plan. At the same time, Mexico signed the Update and became a full partner. Initially conceived of as a "duck plan", the NAWMP is now recognized by signatories to the Plan as contributing to broader goals of biodiversity conservation, sustainable development, and integrated resource management. From 1986 to 1996, actual contributions toward the Plan activities in Canada totalled approximately \$360 million, almost half coming from the U.S. (U.S. partners contributed over \$172 million, Canadian provinces \$80 million, Canadian federal government \$59 million, private sources \$49 million).

Concern over declining waterfowl populations led to managing for results. Partnership organizations and individuals in the three countries co-operate to deliver conservation in high-priority habitats throughout the continent. Waterfowl are enjoyed by many people, including diverse groups such as sports and subsistence hunters, naturalists, conservationists, tourists and other members of the public. Altogether, these people spend millions of dollars on their interest in waterfowl. The NAWMP was drawn up to address this community of interests' concern over the declining populations of waterfowl in North America caused by years of drought in the Prairies and loss of habitat resulting from the conversion of wetlands for agriculture, industry and urbanization.

The Plan's focus on managing for results is demonstrated by its stated objective to restore waterfowl populations through securing, enhancing and managing wetlands and upland habitat. To achieve this objective, the Plan sets habitat goals for the number of wetland and upland

habitat hectares that need to be conserved in North America to recover waterfowl populations to levels recorded during the 1970s. Performance expectations are specified in terms of quantified targets to be achieved by the year 2000.

Several incentives support the Plan's managing for results. The activities under the Plan are co-ordinated by the NAWMP International Committee, made up of members from Canada, the U.S. and Mexico. The Committee consists of a Co-Chair and five members from each of the three countries. The Canadian Co-Chair is the Director, Wildlife Conservation Branch, Canadian Wildlife Service from Environment Canada. Two national councils (Canadian and American) direct project selection and funding.

The key strategy of NAWMP for managing for results is to work through a partnership of stakeholders in the form of regionally based habitat and species Joint Ventures (JVs). These JVs involve federal, state, provincial and territorial government agencies; non-governmental organizations (NGOs); the private sector; and landowners across the continent in co-operative habitat management efforts. Partners, motivated to secure, enhance and manage habitat for different reasons, come together under JVs to achieve results that would be difficult or impossible to do individually.

Joint Venture partners have succeeded in involving private landowners in wildlife conservation, and have worked with industry and local governments to maintain wetland habitats. Partnerships are also with NGOs that provide essential funds and mechanisms necessary for the implementation of the JV objectives. The innovative and partnership-oriented nature of the JVs is a major reason for the success of the Plan's managing for results.

Performance objectives and results are periodically reviewed. Important in managing for results is the need to review the indicators used and the performance targeted. The NAWMP is kept current through periodic reviews of the results achieved at both the continental and Joint Venture levels. The 1994 Update

re-examined the Plan thoroughly and expanded its commitment. The population goals and habitat objectives were reviewed and revised as warranted to suit present conditions. New policy and strategic initiatives were identified to strengthen the Plan. A 1998 Update is currently in process and will be released in summer 1998.

Review efforts support the Plan's managing for results. As part of a continuous learning process, research studies of waterfowl species and habitats are carried out to improve conservation methods. The biological assumptions upon which habitat objectives and conservation strategies are based are tested for validity. Program evaluation techniques are used to provide more reliable assessments of conservation projects, and to better understand the dynamics of waterfowl populations. In addition, on the recommendation of the NAWMP Committee, a Continental Evaluation Team was formed to develop a strategy and answer basic questions about assessing the accomplishments of NAWMP biological programs. The Team has proposed management initiatives and frameworks to address some institutional and technical challenges that face the NAWMP in the coming years. All this review effort supports NAWMP's managing for results.

Results have been achieved.

Management believes that the Plan's managing for results has been successful. After 10 years of operation, it has had a significant impact. In Canada, as of 1996, the Plan partners had conserved and enhanced over half a million hectares of wetland and other habitat, and indirectly influenced improvements to another two million hectares. Waterfowl numbers have greatly increased, with a 1996 estimate predicting a fall flight of 90 million ducks, an increase of 30 million in the last two years and 35 million since 1985. Favourable weather and rainfall have also contributed to the growth in waterfowl populations.

The NAWMP shows how a number of diverse partners with common interests and a shared vision can work together to manage for a common result.

CASE 2: MANAGING FOR RESULTS IN INVESTIGATION AND CONTROL — HUMAN RESOURCES DEVELOPMENT CANADA

nvestigation and Control (I&C) is one of the six service lines of the Employment Insurance Income Benefits business line of Human Resources Development Canada (HRDC). Its activities use the equivalent of approximately 1,100 employees and budgeted expenditures of about \$55 million. One of the principal objectives of the Department is to protect public funds against fraud and abuse by assuring, among other things, that payments are made to those and only those who have the right to them. The I&C function is one of the mechanisms used by the Department to protect the integrity of the Employment Insurance Account. It contributes to this objective by investigating probable and potential abusers and ensuring that employees and claimants issue correct and timely information.

Measuring and reporting the performance of I&C activities have been ongoing. Prior to 1992, there were a large number of I&C performance measures that were, for the most part, activity-and productivity-based. Performance was measured on the basis of efficiency (investigations completed and investigations completed per productive full-time equivalent), rather than on the extent to which these activities contributed to the overall objective of protecting the Account against fraud and abuse. Management believed that these measures led to a focus on inputs and activity levels rather than protecting the EI Account from fraud and abuse.

In April 1992, Investigation and Control management introduced savings as an indicator to measure the extent to which its activities protected the integrity of the EI Account through preventing, deterring and detecting fraud and abuse. This change was implemented in order to shift the focus from managing I&C activities to

managing the outcomes of their activities. In effect, management began to manage for results.

Several factors contributed to the move toward managing for results. This shift in focus was set in motion by a number of developments that created a receptive environment. A departmental shift in priority to focus on re-employment measures required both a redirection and increase in funds. As well, the climate had become more conducive to zero tolerance with respect to fraud and abuse. Stricter penalties were being imposed by I&C policy and later by the new *Employment Insurance Act*. In addition, improvements in information technology permitted the introduction of new I&C initiatives.

The focus on increased detection and prevention of fraud and abuse was facilitated because a directly related indicator had already been implemented, although it had not yet been used to monitor performance. From this point on, however, I&C's amount of total savings achieved has been the key performance indicator for I&C activities. As well, each year I&C resource levels and total savings objectives have been negotiated between the Treasury Board Secretariat and the Department, leading to the establishment of a new base level of I&C resources. The linkage of resources to a savings objective has contributed and is fundamental to managing for results in I&C.

With resources being tied to a results-based indicator, there is a built-in incentive to manage for results, sending a clear message to Investigation and Control management and staff. It has encouraged managers and given them the flexibility to plan for and pursue the appropriate mix of prevention and detection activities appropriate to each region or local area and to discover new initiatives that contribute to protecting the EI Account

against fraud and abuse, for example, examining suspicious Records of Employment before a claim is established.

While Investigation and Control has been in the forefront of managing for results within HRDC, recent commitment by senior management to a departmental results management framework has provided further momentum to I&C's ongoing efforts.

Results have been achieved. Detection and prevention of fraud and abuse of the EI Account have significantly increased over the past five years — as measured by total savings — from \$390 million to \$560 million. A shift to results-oriented management does not alone account for this increase. The increase in I&C dedicated resources and legislative amendments that strengthened penalties also contributed. However, management believes that managing for results, by leading to better focussed I&C activities, has indisputably contributed to the overall objective of protecting the EI Account.

Reporting results contributes to the Department's credibility. The measurement and reporting of the savings achieved, along with I&C's objectives, have permitted I&C to demonstrate accountability both within and outside the Department. The activities of I&C have become more transparent and are potentially more justifiable, which helps to enhance I&C's credibility as it seeks to maximize its potential to detect and prevent fraud and abuse in light of the inherent political and social sensitivities.

Management says that Investigation and Control will continue to develop expertise and databases to provide the information required for good results management decisions and to maintain the credibility of the performance measurement system.

CASE 3: MANAGING FOR RESULTS IN THE TRAVELLERS PROGRAM

he Travellers Program is part of the Customs Border Services (Customs) business line of Revenue Canada. Its activities use approximately 2,600 employees nationwide and budgeted expenditures of about \$113 million. Through this Program, the Travellers Directorate is responsible for the international movement of people and their accompanying baggage as they enter Canada.

The present system of the Travellers Program for managing for results has evolved over several years and is based, to a certain extent, upon the experience gained through trial and error. As far back as the early 1980s, Customs had attempted to implement performance indicators as part of government-wide initiatives such as Management by Objectives, Operational Performance Measurement System, or Policy and Expenditure Management System. These initial indicators were intended to report on daily operational effectiveness. Department officials interviewed stated that the system designed at that time was too broad and attempted to measure too many things at once. In hindsight, the indicators were too numerous, the traveller sample groups were not selected in a meaningful way and the system should not have relied on the field managers to carry out the sampling.

Senior management at headquarters was committed to the concept of measuring performance, but the field management and staff, who had to do all the work, believed there was very little in it for them. The system was too ambitious, too complicated and soon became unreliable due to poor data quality. It became neglected and eventually was abandoned.

A crisis in border non-compliance was key in moving toward managing for results. Interest in performance measurement was renewed when record numbers of Canadians began doing their everyday shopping in the U.S. The number of same-day trips to the U.S. by

Canadian residents jumped from 43 million in 1989 to almost 52 million in 1990. This generated millions of new transactions for the collection of duty as well as long line-ups — up to eight hours — especially on weekends. The view of departmental officials is that the sheer volume of travellers placed great pressure on routine operations at many land border crossings. Rather than waiting in long lines of returning shoppers to obtain customs clearance, travellers began leaving Customs offices without paying duties or taxes, fuelling a surge in non-compliant behaviour.

Revenue losses were significant and Customs became the focus of national media attention. Politicians called for action. To respond effectively, the Travellers Directorate needed to know how and where to focus its finite resources and to determine which travellers required more in-depth customs examinations. It also needed reliable information about the amount of smuggling taking place and where it was occurring. According to departmental staff, this tremendous challenge initiated the re-engineering of the Travellers Program.

Facing these operational difficulties, the Travellers Directorate turned to the lessons learned from implementing the previous system and introduced, at first on a very small scale, the "stint" performance measurement (sampling) system. It was given the name "stint" since teams of field staff are temporarily assembled for five days at a time to conduct performance measurements of the border offices. The system started in 1991 with a single indicator, compliance rate — the percentage of travellers who voluntarily comply with the laws governing entry in Canada. Measurement was carried out by the sampling teams under the full-time supervision of headquarters. This approach was born in response to "real and immediate" operational needs and a demand for service that gave managers at all levels a strong vested interest in

obtaining credible results. Managers believe the approach proved successful because results pointed to areas where resources should be focussed. The measurement system was expanded in 1992–93 to include all major land border offices and a baseline was established from which to gauge improvement. Major airports were included in 1994–95. The system provided a quantitative insight into performance at the border office level, as well as regionally and nationally, that was comparable over time.

The commitment and leadership of senior management was critical.

Departmental staff interviewed indicated that successful implementation depended upon the leadership, commitment, and hands-on involvement of the senior managers. Even before the present system, they had been strong consistent advocates of performance measurement. Currently, they use compliance results to guide decisions about how to adjust activities in collaboration with the managers being measured, as well as to publicly point to the contribution of Customs. They are persistent in their efforts to spread the acceptance and use of these performance measures. The assistant deputy minister (ADM), Customs, actively "markets" managing for results with other ADMs, as well as regularly emphasizing its importance with all levels of staff during training sessions.

With the encouragement of government-wide service standard initiatives to improve service quality, the "stint" system was refined and expanded to include additional indicators. In 1993, the Travellers Directorate developed indicators to measure *client satisfaction* and wait-times for travellers. The information and feedback obtained through this process has led to many improvements in service, including the design of facilities to reduce wait-times and new information pamphlets to facilitate voluntary compliance.

CASE 3: MANAGING FOR RESULTS IN THE TRAVELLERS PROGRAM (CONT'D)

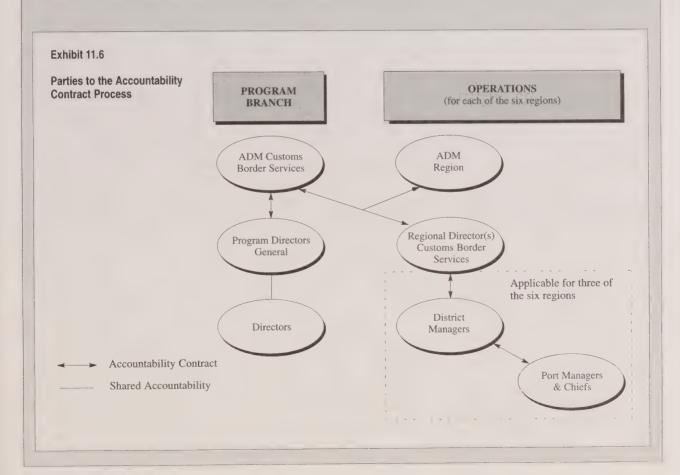
Accountability contracts contribute to linking long-term objectives to indicators. In 1996, Customs took another step. It embarked on a joint planning process with the regions to produce accountability contracts between the ADM, Customs, the (six) regional ADMs, and the respective regional directors. The accountability contracts link the long-term objectives to indicators and goals for headquarters and the various regions of the Department. Expected performance for the fiscal year is stated and is the subject of discussion and input from field staff. Although accountability contracts were not required within the regions, three regions established additional accountability contracts with the next levels of authority to obtain the commitment of district managers, port

managers and chiefs (see Exhibit 11.6). The Department intends to continue the process, with improvements to allow the contracts to be used as a basis for performance appraisals.

Environment is changing. Travellers Directorate indicates that present volumes are manageable and it has a good report card from the public. But there are signs of deterioration at major sites, indicated by increased client dissatisfaction and wait-times, as a result of growing casino traffic and increasing flight arrivals under the Open Skies Agreement. At certain sites, the current Primary Inspection Line (PIL) system design has been stretched to the limit. The management of the Travellers Program recognizes that current service and compliance levels will not be sustainable at high-volume sites in the

future, and that it must accelerate its re-engineering initiatives.

Important lessons have been learned in managing for results. The management and staff of the Travellers Directorate indicated that they learned important lessons. First, it is critical that senior management proactively promote managing for results with hands-on involvement. Second, the focus must be on only a few key indicators that are simple and easy to understand in relation to operations. Next, the indicators must be measured objectively and credibly and, in particular, managers should not measure their own performance. Finally, the disruption of measuring the performance of operations must be minimized, ensuring that it is not a burden on those delivering the program.



CASE 4: MANAGING FOR RESULTS IN THE UNITED STATES COAST GUARD

erformance reporting is legislated.
Under the 1993 Government
Performance and Results Act (GPRA), the
United States federal government initiated
several pilot projects, one of which
involved the Coast Guard's Office of
Marine Safety and Environmental
Protection.

The starting point for the Office of Marine Safety and Environmental Protection, in 1992, was an organizational assessment that showed that overly centralized management, based on optimizing outputs, was frustrating the attainment of desired outcomes—notably, saving lives. Among the outputs emphasized were activity-based performance measures, such as the numbers of vessels inspected and certified.

Strong leadership was key. With strong leadership from a senior manager, a new planning framework was developed. The first business plan articulated key performance goals over a five-year period, and performance indicators. An example of a performance goal for marine safety is to reduce accidental deaths and injuries from maritime casualties by 20 percent over five years; the corresponding performance indicators are worker fatalities per 100,000 workers, and

non-worker fatalities per billion tons of commerce.

Emphasis was placed on risk management; the main use of performance information is to affect the outcomes themselves. By disaggregating high-level measures, like worker fatalities and passenger-vessel casualties, the Coast Guard has begun using trend and risk information to redirect activities and resources toward goals. Through better communication of results to field staff, and risk assessment training, performance information is combined with local knowledge to identify approaches to reducing risk. In particular, partnerships with local stakeholders have helped to improve results and better target resources.

Performance information is being used. Performance information is being used in a variety of management and decision processes, including the development of a multi-year budgeting strategy.

Lessons were learned. The Coast Guard has rescinded all performance standards that were not mandated by statute or other formal requirement, thereby enhancing managerial flexibility by the equivalent of 0.5 million work hours annually (8.5 percent of direct program staffing).

The Coast Guard is extending the GPRA pilot to cover all of the operating programs

of the agency. Among the lessons and challenges from the experience to date are:

- the importance of the personal involvement of senior line managers;
- the need to fundamentally rethink programs: not about what you do, but about why you exist;
- the need to extend outcome goals and indicators beyond what the agency controls—an ongoing issue is to establish firm linkages between activities and outcomes;
- the value of setting challenging goals;
- the importance of performance measures being relevant to senior management, and usable in managing activities and resources;
- the challenge of further extending managerial flexibility, which is inherent (and necessary) in the process and one of the strongest incentives; and
- the proof of successful managing for results is whether things are getting better in the real world. For example, the focus on saving lives led to measures to deal with high fatality rates in the towing industry, which has contributed to a significant decline in those rates.

Source: U.S. Coast Guard. Using Outcome Information to Redirect Programs: A Case Study of the Coast Guard's Pilot Project under the *Government Performance and Results Act*, 1996.

CASE 5: CREATING A CLIMATE FOR MANAGING FOR RESULTS AT THE CANADA CENTRE FOR MINERAL AND ENERGY TECHNOLOGY (CANMET)

ANMET is a research and technology development arm of Natural Resources Canada (NRCan), with about 700 employees and an annual budget of about \$90 million. Through its research facilities across Canada and its funding programs, CANMET works with the minerals, metals and energy industries to find safer, cleaner and more efficient methods to develop and use Canada's mineral and energy resources. Prior to reorganization. CANMET was a single entity consisting of both energy and mineral technology. In 1995, CANMET was split into two sectors — the Energy Technology Branch and the Mineral Technology Branch.

Senior management leadership was key.

As a primary technology developer, CANMET had little direct impact on the marketplace for technology. Its market impacts came from third party investment and marketing of CANMET's technologies. Managing for results began in 1987 after the arrival of a new assistant deputy minister (ADM) who was brought in to make CANMET more relevant to industry. In response to pressure from industry, cost-conscious and results-oriented management practices were progressively adopted in the fields of energy, minerals, and metals science and technology. A supportive organizational climate to manage for results came from CANMET's increased reliance on partnership and consortium arrangements with private sector companies. Such alliances with the private sector have encouraged CANMET to adopt the businesslike and results-oriented approach of its industrial partners to secure their confidence, to have a compatible working relationship with them, and to provide major benefits to research and development (R&D).

According to management, prior to the new ADM's arrival, the main measure of individual performance was the number of scientific publications produced. Key performance indicators focusing on the benefits to industry were developed to demonstrate achievement of results.

Mid-year and year-end reviews of

accomplishments were also emphasized. Adopting a more businesslike approach included preparing CANMET's first Business Plan in 1987, and a Corporate Plan in 1990. By 1990, CANMET was very much involved in impact measurement, which attempted to establish the value of the organization to industry.

CANMET's senior management continues its commitment. In selecting research and development projects, a greater emphasis is placed on the potential for commercial application of technologies as well as their potential for achieving the intended socio-economic benefits. Recovering CANMET's R&D costs is considered in reaching project agreements with industrial partners. CANMET has formed many alliances and partnerships with industry, other federal departments, provincial governments, universities and international agencies to share the costs and risks of research and development. The Department believes that such alliances ensure that Canada achieves maximum return on its R&D investment and facilitates the implementation and commercialization of CANMET-sponsored technologies by industry to generate wealth, create jobs and improve the quality of life for Canadians.

Management states that CANMET's shift to managing for results meant that the organization was ready for the changes imposed by the federal government's Program Review in 1993–94. Officials interviewed indicated that there was fear that the impending Program Review would cut CANMET's budget if the results and benefits of the program were not measured, made visible and demonstrated.

Many incentives support the move toward managing for results.

Performance information is included in the accountability accords between the ADM, director general, and directors. These accountability accords are used for appraising the performance of managers by comparing their actual achievements with mutually agreed-on performance expectations.

A number of other departmental initiatives have continued to provide a supportive environment for managing for results. The managerial practices of NRCan have undergone substantial changes during the last few years. The adoption of a business planning process and Total Quality Management have prompted management to take more interest in the business value of investment in science and in meeting the business objectives of industrial clients. Efforts to increase client satisfaction with CANMET's services encourage staff to manage research and development projects to meet the specific commercial needs of industrial clients. NRCan is also developing and piloting a Science and Technology Management Framework, which is focussed on performance.

Recent federal government initiatives to renew the Expenditure Management System have also helped CANMET managers to maintain their focus on managing for results.

CANMET's environmental scanning demonstrates a capacity to learn and adapt. Business Plans include the results of business environmental scanning to identify emerging changes in related technology, business conditions, economy, government regulations, and managerial conditions. The Business Plans of the Energy Technology Branch and the Mineral Technology Branch include information on external and internal factors that are likely to impact on the operations of CANMET. Relevant issues and developments, and the branches' responses to the emerging changes and challenges are explained.

In terms of lessons learned in moving toward managing for results, departmental officials indicated that a results management culture and understanding must be developed before the practical tools can be implemented. Officials have indicated also that CANMET's next step in the move toward managing for results entails continuing the search for even more meaningful indicators that can be used as feedback in the decision-making process.

CASE 6: CREATING A CORPORATE CLIMATE FOR MANAGING FOR RESULTS AT ENVIRONMENT CANADA

nvironment Canada, with about 4,600 employees and expenditures of approximately \$546 million, is a science-based department with a mandate to preserve and enhance the natural environment, and its renewable resources (including migratory birds and other non-domestic flora and fauna); conserve and protect our water resources; carry out meteorology; enforce the rules of the Canadian-U.S. International Joint Commission; and co-ordinate federal environmental policies and programs.

Senior management was instrumental in creating a corporate accountability framework. Faced with shrinking resources and the need to simplify the reporting of its programs, the deputy minister (DM) in 1991-92 started an initiative to integrate program results for the Department through a corporate accountability framework. Successive DMs continued this work, and their leadership and commitment encouraged the assistant deputy ministers (ADMs), regional directors general, and other executives to adopt managing for results and accountability practices. The Parliamentary Standing Committee on the Environment and Sustainable Development also played a role. In discussing the Department's performance report in November 1996, the Committee asked that the Department be able to demonstrate the progress it is making.

Exhibit 11.7 depicts the corporate accountability framework in which Environment Canada sets out how performance is to be measured in its three business lines: securing a healthy environment, ensuring safety from environmental hazards, and building a greener society.

The Department's budget is apportioned through four activities – three externally focussed business goals or lines, which are in turn divided into 10 components – and a fourth internally focussed activity called "Corporate Administration".

Discussion forums communicate commitment across the Department. Each component has its own forum, or "table", of managers from across the Department to facilitate intra-departmental co-operation of the groups that are making a contribution to each component's goal. The tables are co-led by an ADM and a regional director general. The component system of planning and reporting allows for managing toward results that requires co-operation across the organization. Although the Department believes this approach to be effective in developing consensus on its program direction and commitments, it continues to explore ways to simplify this approach and to link planning to expenditure management — while preserving the focus on integrated results delivery.

Every year, each of the 11 tables of Environment Canada managers, with their clients and partners, prepares an action plan identifying clear results statements, major deliverables and performance indicators. These action plans then serve as the basis for developing departmental documents such as the Corporate Business Plan, the Minister's Action Plan, the departmental Performance Report, and the Report on Plans and Priorities.

The Department's vision, mission and results are publicized. Environment Canada's senior management shows continuing commitment by emphasizing results in published planning documents and using results to assess management performance. The Department's overall vision and mission, as well as those of its business lines, are clearly articulated in the departmental documents.

Learning and adaptation is fostered. To foster learning and adaptation, the results of Environment Canada's evaluations and reviews are being integrated into the process of corporate planning, performance measurement and

accountability. The emphasis of reviews includes performance monitoring and reporting, implementing service standards, organizational learning and responsiveness, the achievement of results and accountability mechanisms or frameworks. This revised functional responsibility helps to build a results-based management culture in the Department.

Lessons learned. Environment Canada's performance requires making, maintaining and enriching partnerships with other jurisdictions in Canada and other countries and with other sectors. Achievement of its goals are predicated on mobilizing others to act. In developing indicators in this context, the Department has learned that indicators are needed that:

- measure a range of results, from short to long term;
- pertain to the results of more than a single activity;
- reflect the cumulative impact of several partners; and
- measure system-wide results rather than focus on a single aspect of the ecosystem.

The accountability framework provides several benefits. Department representatives indicated that the accountability framework provides significant benefits. First, it facilitates speed — it is an effective mechanism to bring parts of the Department together quickly and mobilize knowledge. Second, Environment Canada could begin to answer horizontal questions, efficiently drawing information from across the Department. Third, the Department considers the framework a significant step toward resourcing trade-off decisions, but recognizes that there is a long way to go yet. Finally, the framework is important for maintaining focus on priorities and the long-term view (typically 25 years) for effort in the environment area to achieve results.

Environment Canada Accountability Framework

A GREENER SOCIETY	tion Technologies, Partnerships for s and Jobs and Sustainable ses Capacity-building Development			
ROM L HAZARDS	Emergency Information Prevention and Products and Preparedness Services			
SAFETY FROM ENVIRONMENTAL HAZARDS	Weather and Environmental Prediction			
	Conserving Canada's Ecosystems			
TN	Biodiversity/ Wildlife			
A HEALTHY ENVIRONMENT	Compliance and Enforcement			
	Toxics			
	Atmospheric Change			
Business Line	Component	Issue	Canada's Goal	Environment Canada's Focus

COMPONENT	BIODIVERSITY/WILDLIFE
ISSUE	The diversity of plant and animal species is declining globally at an alarming rate
CANADA'S GOAL	Conserve and enhance Canadian and global biodiversity
ENVIRONMENT CANADA'S FOCUS	Act nationally and internationally to protect and recover endangered species, sustain migratory bird and other wildlife populations, and conserve wildlife habitat
ACTIONS	Designated wildlife populations under federal jurisdiction, sustained at or increased to healthy levels
Results	ban use of lead shot for migratory game bird hunting in all National Wildirfe Areas (1996–97) and across Canada (1997–98)
/ Deliverables	develop partnership for landbird conservation with provinces, territories, and non-governmental organizations (1996–97)
	implement Protocol to Migratory Birds Convention through co-operative wildlife management regimes (1996-97)
*	Significant wildlife habitat protected and enhanced
	establish eight National Wildlife Areas and two Migratory Bird Sanctuaries
	secure habitat and influence land use practices under North American Waterfow! Management Plan
	implement provision for conservation land donations (1996–97)
*	🖐 National framework in place to guide effective conservation of Canadian biodiversity
	implement Canadian Biodiversity Strategy
	create national biodiversity science table (1997–98)

Note: Management and Administration is the 11th component and is a part of all three business lines.

- 11.51 As well, experience has shown that any disincentives, inhibitors or constraints that discourage managing for results need to be dealt with if lasting progress is to be made. The starting point for a shift to managing for results in the U.S. Coast Guard was a 1992 assessment that showed that the attainment of desired outcomes saving lives was frustrated by overly centralized management that emphasized outputs, such as the number of vessels inspected and certified.
- 11.52 Innovation will be needed to implement managing for results. This implies a certain amount of trial and error. It is important that the response to mistakes incurred while innovating is measured and balanced and does not serve as a disincentive to further needed innovation. It is necessary to learn from errors and to move on.
- 11.53 **Expertise in measurement** concepts and practices. Management and staff may not immediately understand how measurement is best implemented, and may not fully understand, without advice, the implications that results-based measures have for managing operations. Unless managers and staff become comfortable with measurement, resistance to managing for results is likely. Management of the Employment Insurance program's Investigation and Control function found, for example, that savings indicators were not implemented as rapidly as they could have been because managers initially did not see the measure's implications for deciding which cases to investigate.
- 11.54 Consequently, managing for results requires training and communication on key concepts, as well as the exchange and sharing of experience, knowledge and best practices. In a report on progress in implementing

- the U.S. Government Performance and Results Act, the U.S. General Accounting Office stated: "To make the most of results-oriented management, staff at all levels of the organization must be skilled in strategic planning, performance measurement and the use of performance information in decision making. Training has proven to be an important tool for agencies that want to change their cultures."
- Adaptive capacity. Maintaining the capacity to achieve program results requires a learning organization, one that stays relevant and responsive to the changing needs of clients and the general public. Managers need the capacity to prepare themselves to cope with emerging challenges. The proactive monitoring of the business environment for emerging challenges and their potential impact on programs and program management is part of this capacity. Determining the effective responses involves systematically reviewing past experiences, learning lessons from past mistakes, and taking action to avoid repeating the same mistakes. The North American Waterfowl Management Plan, for example, operates on a 15-year planning horizon and is updated every five years. Evaluations test the assumptions of the Plan and provide information on the effectiveness of specific approaches.
- 11.56 The changing nature of government programs constitutes a significant barrier to implementing and maintaining a focus on results. Because of this, implementing practices for managing for results is never really finished. Restructuring in Natural Resources Canada led to CANMET being split into two separate branches in 1995, at which time its functions were joined with related policy functions. Due to the splitting of CANMET, and to other reorganizations,

the business plans had to be restructured and only recently reflect CANMET's orientation toward managing for results as clearly as they previously did.

Agreeing on expected results is key

- 11.57 Without agreement on what a program should be trying to accomplish, it is difficult for managers and staff to focus their activities and to agree on the success of these activities. There needs to be agreement on:
 - objectives, especially outcomes;
 - · performance indicators; and
 - specific performance expectations.
- 11.58 To avoid confusion, there also needs to be agreement on the terminology used. For example, Environment Canada has arrived at definitions of "outputs", "intermediate outcomes" and "long-term outcomes", linking these concepts to the kind of information required regarding the results of its activities.
- 11.59 As illustrated in Exhibit 11.8, CANMET has established internal agreement on expected outcomes through management retreats, discussions with management and staff and the use of accountability accords between executives and managers. Committees of directors general provide a forum for sharing experiences and practices and the exchange of information. Agreement outside the Department is fostered through the use of advisory committees involving external stakeholders.
- 11.60 Program objectives are the first step. Our cases provided good examples of clear statements of the results to be accomplished. Program objectives were stated as short-term, intermediate or ultimate outcomes or results to be accomplished, rather than as activities to be carried out.

- part of ensuring the efficiency and effectiveness of a program. However, outcomes represent the true value resulting from the investment of tax dollars. Therefore, managing outcomes, as well as outputs and activities, provides greater assurance that the intended value, reflected in the organization's mission and overall objectives, will be achieved. To accomplish this, there needs to be agreement on what outcomes are implied by the mission and objectives.
- 11.62 Appropriate performance indicators are agreed to. Results can be measured in many ways, using many different kinds of information. A performance indicator is the measure actually used to assess a specific aspect of performance. No single indicator is adequate, and choosing the best set of performance indicators is central to ensuring that the right results are being measured. Without agreement on a balanced set of appropriate indicators, there is a risk that inappropriate performance will be encouraged. A balanced set of indicators will typically include indicators of both outputs and outcomes that reflect the key aspects of program performance.
- For example, in developing a 11.63 measure of the success of its efforts to detect and deter fraud and abuse, Investigation and Control management noted risks to focussing on "direct savings"—the total value of overpayments established and related penalties imposed. Inappropriate behaviours could be encouraged, such as allowing cases to "age" so that a larger amount could be recovered. Also, a focus on direct savings could have detracted attention from preventing fraudulent claims. To address these concerns, management added "indirect savings" ---

Without agreement on what a program should be trying to accomplish, it is difficult to focus activities and agree on success.

Choosing the best set of performance indicators is central to ensuring that the right results are being measured.

Without agreement on clear and concrete performance expectations, it is difficult to know what is expected.

an estimation of the amount of inappropriate payments prevented through early intervention in a case. Investigation and Control also tracks a small number of secondary indicators, such as return on investment (the ratio of the total savings generated to the total I&C operating costs) to help ensure that its efforts remain cost-effective.

11.64 Agreement on clear and concrete performance expectations.

Performance expectations describe the desired level of performance. Without agreement on clear and concrete performance expectations, it is difficult to know what level of performance is expected and to assess the extent to which expectations have been met.

11.65 Expectations are often expressed as targets. To be meaningful and to motivate staff to perform better, performance targets are frequently set to

Exhibit 11.8

CANMET: Reaching Agreement from the Bottom up on Expected Results Mission, objectives and indicators focus on outcomes. CANMET's Annual Report for 1995 and its Corporate Business Plan for 1994–97 (before the recent reorganization of CANMET) state that CANMET's mission is to perform and sponsor predominantly commercial and cost-shared R&D and technology transfer (minerals, metals, and energy), in partnership with industry and other clients. CANMET's mandate is: to enhance the competitiveness of Canada's minerals, metals, and energy industries; to improve and develop energy efficiency and alternative energy technologies; to improve health, safety and environmental control in the client industries; and to support government policy initiatives. In fulfilling its mandate, "CANMET is uniquely positioned to play a lead role in helping its client industries to generate wealth for Canada, create new jobs, protect existing jobs from foreign competition, increase exports and reduce dependence on imports."

The above-noted descriptions taken together clearly convey what final outcomes or end results are to be achieved through CANMET's R&D projects and subsequent transfer of innovative technology to its industrial partners.

A set of key performance indicators measures the effectiveness of CANMET's interaction with its clients in levering funds, attracting financial contribution from industry, and promoting staff secondments. The indicators include full-time equivalents on staff secondment and interchange, value of task-shared and cost-shared work, revenue generation, and cost-effectiveness and cost-benefit ratios.

Consultative process ensures agreement from the bottom up on indicators and expectations. CANMET has taken a consultative approach to building indicators and expectations from the bottom up. Management retreats are used to develop business plans. Officials interviewed stated that these proposals are further discussed by middle-level managers and staff. As well, accountability accords between executives and managers include some of the same mutually agreed-on indicators, which are tied to the business plans. Such a consultative process helps to build consensus on key performance indicators, principles and values, direction and business planning among the different levels of management.

As well, officials stated that departmental committees of directors general provide a forum for sharing experiences and practices and exchanging information. This information is transmitted to the Department's management committee in order to support the management of science and technology in the Department. This is one way in which information is fed to departmental management.

Industry committees provide advice on expectations and indicators. With the move to a more businesslike approach, CANMET devised key performance indicators. Several committees have a role to play in advising CANMET management on the targets, the performance and the methods used. Representatives are chosen primarily from industry (CANMET's principal source of clients). As part of the advisory process, representatives provide advice and recommendations to the Minister on the overall performance of CANMET and also on specific issues, such as the need to revise or adjust targets.

be challenging, but attainable. The North American Waterfowl Management Plan set targets for waterfowl populations and habitat conservation based on the partners' collective perceptions that population levels of the early 1970s were healthy and met public needs.

The targets can provide the basis 11.66 for a performance contract between subordinates and their supervisor. The use of an appropriate participatory or consultative process in developing and implementing systems to measure program performance helps managers and staff to reach agreement on the system components, and to secure their commitment to use them. Such a consultative process helps to draw on the variety of skills and experiences of managers and staff and to develop sound and balanced results expectations. Customs Border Services of Revenue Canada, of which the Travellers Program is part, undertakes a joint planning process with its regions, producing accountability contracts between the assistant deputy minister (ADM), regional ADMs and regional directors. The accountability contracts specify expected performance and are the subject of discussion and input from field staff.

Performance Is Measured to Improve Results

- 11.67 Managing for results means accepting responsibility for results, improving them where feasible, and demonstrating accountability by reporting them. Improving results requires:
- measuring and reporting performance;
- using performance information to refine, focus and improve activities; and
- reviewing and updating indicators and measures.

Because performance and the environment influencing it are not static, review and updating of indicators and measures are also required.

Results are measured and reported

- 11.68 Measurement is the foundation on which results management is built. Without knowing the level of results being achieved, it is not possible to determine whether the results are adequate, how much more needs to be achieved to reach the desired level, and what efforts are needed to get there. Managing for results entails practices for collecting, assessing and internally reporting credible information on results and related program costs.
- 11.69 Exhibit 11.9 illustrates that the Travellers Program uses ongoing measurement and periodic studies to assess changes in performance and progress toward outcomes. It also shows that the information is reported to all levels inside the organization for use in decision making and management, and is also reported to outside users.
- 11.70 A reluctance to measure and report outcomes has at times been a barrier to measuring and reporting results. Managers may be reluctant to measure and report outcomes, because these are often influenced by factors outside the control of the program and are therefore not under the control of management to the same extent as are outputs. Management will have direct control over such outputs as the number of inspections conducted, and the number of reports produced, but considerably less control over the impact these have on the behaviour of program clients and the resulting consequences for Canadians in general. The potential clients of the information may question the extent to which reported results can be attributed to program activities, which can contribute

Improving results requires that they are measured and the information reported and used.

Outcomes are the most important indicator of the value received from public funds.

to management's reluctance to measure and report outcomes. Yet it is outcomes that are the most important indicator of the value received from public funds.

11.71 One lesson that has been learned is that a number of approaches to measurement may be needed. Outcome indicators will generally tell only how well the specific characteristic being measured is doing, not necessarily what the program's contribution has been. For this reason and other reasons, a number of approaches will be necessary.

11.72 Results can be measured in several ways — through ongoing measurement systems, periodic evaluation studies, occasional reviews, ad hoc cost/benefit analyses, client surveys, benchmarking comparisons, or long-term longitudinal studies — as appropriate to the nature of the program and the type of indicators used to measure performance. A combination of approaches is often necessary. Both quantitative and qualitative measures have a role.

11.73 Managers need to know more than simply the results. Measurement,

Exhibit 11.9

Measurement of Traveller Compliance Is Used to Improve Results Ongoing measurement and periodic studies assess changes in performance and progress toward outcome targets. Compliance and responsiveness studies ("stint" studies) are carried out two or three times per year at each major port to test levels of traveller compliance and satisfaction. These studies are intended to yield statistically reliable results. They are conducted by examining travellers at random after they have been screened by Customs inspectors at the primary inspection line. The results are then rolled up by major ports, regionally and nationally.

Current and projected performance results are assessed against actual levels of accomplishment reported in previous years. For example, the estimated 98 percent compliance rate for travellers entering Canada at highway points of entry in 1997–98 represents an increased target compared to the 1992–93 baseline of 94.9 percent.

Regular reporting provides timely information on progress toward outcome targets. The performance information is reported to the assistant deputy minister (ADM), Customs, the respective regional ADM and the director, Customs Border Services, as well as the border office examined. The performance information is used to determine whether progress toward the objectives agreed to in accountability contracts is on track at mid-year, and met by year-end. Improved program performance is facilitated by sharing and comparing the results in other areas of the country, maintaining dialogue and attempting to duplicate successful approaches. Customs Border Services published its achievements in the Revenue Canada Performance Report for the period ending 31 March 1996, and its results expectations in the 1997–98 Estimates — Report on Plans and Priorities.

Information is used to improve operations. The results of stint studies are used to adjust operations at the ports. For example, if non-compliance is high, the port's Customs inspectors would increase the number of travellers referred to secondary inspections or step up other enforcement activity, such as using "flexible response teams" to examine certain groups of travellers.

Information on compliance is used to focus enforcement activities. Using stint study information on potentially high-risk categories of travellers (i.e. places travelled, duration of travel, season of travel, and exemption claimed), Customs staff can optimize the effectiveness of their enforcement activities by targeting those high-risk categories.

Outcome and operational information is used to predict staffing requirements. Operational data such as volume of travellers, expected compliance rate, examination rate, and appropriate time standards for inspections are used by headquarters in a computerized modelling system to calculate required staff resources. The staffing information is then used to determine the number of staff needed to process the expected volume of traffic and meet the performance targets and standards.

perhaps through evaluations, should help managers to understand the extent to which the activities of their programs actually contribute to desired objectives, in relation to the role played by other factors.

- 11.74 In some instances, the required information may already be available. In other instances, additional or new information collection practices will have to be implemented. At the time of implementing the NAWMP, waterfowl populations were already being monitored on an annual basis. However, measurement of the area of habitat protected had to be implemented to monitor progress toward meeting targets for this important result.
- 11.75 Another lesson that has been learned is that it is important to limit measurement and reporting to a restricted number of indicators. Indicators or measures of performance are most useful when they reflect the key dimensions of program performance. Since outcome, impact or effectiveness indicators are relatively less common than other types of performance indicators in government departments, and because of their crucial importance to managing for results, we have focussed on such types of indicators in this study.
- 11.76 The number of indicators chosen should be manageable, relevant and appropriate to the needs of the users of such information. Managers in the Investigation and Control function and the Travellers Program found that having too many indicators was a barrier to their use. Managing for results took hold when fewer key indicators were used.

11.77 Credibility is important. Reliable procedures for collecting data and assessing results against expectations are essential for providing credible and

understandable information to program managers. This may involve specific assessments of the reliability of information. Reliability stems from how the indicators are measured and from the quality of the information used. Assuring credible information may require formal assessment of measurement procedures and data. In discussions between the Treasury Board Secretariat and Human Resources Development Canada for additional resources to obtain additional savings through Investigation and Control activities, the credibility of estimates of direct and indirect savings was paramount. Credibility was aided by conducting an evaluation of these indicators, independent of program management.

Performance information is used to improve performance

- 11.78 Measuring results is not sufficient. Managing for results means that performance information is integrated into the decision-making process and used. Exhibit 11.9 shows how the results of ongoing measurement and periodic studies in the Travellers Program are used to adjust activities, focus enforcement activities and predict staffing requirements.
- 11.79 Improved performance requires that, in addition to being reported and used externally, information be used internally to improve related management practices and program activities, as well as to support decision making. In our cases, we found a number of instances where results information was used to improve departmental practices, including the following:
- Improve planning. In 1994, the NAWMP was reviewed and updated based on results achieved, weaknesses and challenges. The updated plan implemented several recommendations regarding bird populations, habitat and

Managing for results means that performance information is integrated into the decision-making process and used.

supporting policies. Evaluation of the results of specific Joint Ventures is used to select the most effective habitat conservation methods. In the Prairie Habitat Joint Venture, a computerized planning model uses performance data to forecast costs and results.

- Focus activities better. Investigation and Control uses performance information to focus activities on areas likely to yield the greatest savings.
- Assess policies, practices and regulations. Investigation and Control has recently set up a unit in order to use performance information for assessing the implications of proposed changes to policies and practices. Environment Canada uses waterfowl population counts to review and modify hunting regulations.
- Assist in resource allocation or reallocation. Customs Border Services uses information on traveller compliance as one of the inputs to a computer model used to calculate staff required for border offices to meet performance targets and service standards. The Department has used traveller compliance levels and service quality indicators, along with other performance information, to support requests for and obtain additional resources. Environment Canada is working to link its results information to expenditure management, to aid in making difficult program choices.
- Demonstrate accountability between levels of management and assist in performance appraisal. In CANMET, Performance Feedback Reports compare achievements against performance expectations included in accountability accords. These are discussed by supervisors with their subordinates during mid-year and year-end reviews and annual performance appraisals.
- Monitor for problems and correct them. Customs Border Services uses information on traveller non-compliance

to identify border offices where increased inspection and enforcement are necessary.

In Chapter 5, Reporting Performance in the Expenditure Management System, we observed that communicating the use of results was an incentive for performance reporting. The visible use of results can also serve as an incentive to manage for results. For the North American Waterfowl Management Plan, making the use visible included making the results visible. The NAWMP published its performance information in its 10th Anniversary Report, Taking Flight, Joint Venture reports, such as the Prairie Habitat Joint Venture report, Conserving an International Resource, and other documents. These vehicles serve to communicate the goals and results achieved and to educate the public on the benefits of the conservation of wetlands and waterfowl. The Plan's high public visibility and international partnership arrangements contribute to making the value of the program well understood, thus helping to protect its resources. This has acted as an incentive for participating government officials to manage for results.

Indicators and measures are reviewed and updated

- 11.81 Because of the changing environment in which government programs operate, the implementation of managing for results is never complete. Experience suggests that all performance measurement and reporting systems can be improved.
- 11.82 Improvements may be needed to keep pace with a changing environment and with needs of the public. New program policy and features, and changes to priorities, budget levels, program delivery mechanisms, or organizational structure can quickly outdate a performance information system, affecting

The implementation of managing for results is never complete.

its credibility among users. Consequently, the relevant components of a performance information system must be modified to make the system relevant to prevailing circumstances, and to maintain its validity and credibility.

- 11.83 Based on experience gained within a program, changing circumstances, and experience gained in similar programs elsewhere, the performance indicators, expectations, and measurement and communication strategies used will need periodic review and improvement. The best strategy is to begin with a reasonable set of indicators and measures, and to continue to refine and develop them with experience.
- 11.84 Improvements may also be needed to adapt to changing levels of performance. With experience over time, an organization learns to perform better. Under these circumstances, performance targets used previously may no longer be challenging or realistic. Consequently, performance expectations need to be revised periodically to better reflect an organization's current operational capacity.
- 11.85 Review of the NAWMP reflects the need to adapt both to changing needs and changing levels of performance. The Plan, originally conceived of as a "duck plan", appears to have been successful in increasing waterfowl populations. Based on its success and current conditions, the 1994 review resulted in revision of waterfowl population goals. The Plan has also been expanded to include multi-species and biodiversity objectives to support the broader goals of biodiversity conservation, sustainable development and integrated resource management. In particular, management believes that the Plan's reflection of broader benefits and values of wetlands and associated habitats will help to

maintain and broaden the Plan partnership.

Conclusion

- 11.86 Many countries throughout the world recognize the need for managers to focus on obtaining desired results both to meet concerns of citizens about the effectiveness of government programs and to ensure that good value is obtained for the increasingly stretched tax dollar. We found enough experience in Canadian and other jurisdictions to set out a framework for managing for results, to confirm the application of the framework to federal government programs in Canada and to identify some related good practices.
- 11.87 Managing for results benefits
 Canadians by contributing to better
 program performance. It also benefits
 public service managers by adding
 credibility to their efforts and assisting
 them in many of their management
 responsibilities, such as planning, decision
 making, responding in a timely fashion to
 queries, focussing activities and
 identifying and finding solutions to
 problems. And finally, it benefits ministers
 by focussing programs on the benefits
 they want to achieve for Canadians.
- 11.88 Past experience shows that shifting the focus from managing inputs to managing for results is not easy, but it can be done. The change takes time, usually about four to five years. Key to managing for results is persistence and the creation of a receptive climate, both across government and within individual programs and organizations.
- 11.89 Creating the climate presents challenges. Barriers are created by existing incentive systems that reinforce the management of inputs and activities, and by conflicting goals and public sensitivities. Key among these barriers is

Shifting the focus to managing for results takes time.

the desire to avoid risks. Overcoming these barriers requires strong leadership that can recognize the opportunity created by significant events in the organization or its environment and by communities of common interests in external partnerships. In organizations that manage for results, this leadership is shown by senior managers who overcome barriers by recognizing and communicating the value of information on results, consulting and seeking agreement on expected results and their measurement, providing supporting incentives, ensuring that the required expertise is developed and ensuring that risks are dealt with rather than avoided entirely.

11.90 Such change does not come without costs. Nonetheless, many of those who are managing for results see the costs of doing so as "part of doing business", entailing no additional costs beyond that of the management practices replaced.

11.91 However, where the necessary supporting systems are not in place, costs will be incurred by their implementation. Careful consideration needs to be given to ensuring that the costs of the measures chosen are reasonable in relation to their benefits. The cost of not managing for results is less efficient and less effective programs.

11.92 Experience with managing for results is not yet widespread in the federal government. Ensuring continued progress will require ongoing attention and leadership across government, as reflected in efforts to improve reporting to

Parliament and to encourage the sharing of experiences among government departments. It will also require internal and external decision makers to show that results count in good management by asking for information about results and by visibly using it as a basis for their decisions.

11.93 As leadership changes and as programs and their environments change, progress that has been accomplished can come undone. For this reason, an organization that manages for results is a learning organization — one that continually monitors its environment and learns from its experiences and past performance.

Treasury Board Secretariat's response: We are pleased that the Auditor General has undertaken a study on managing and accounting for results in the federal government. We agree that establishing a climate within government that balances incentives for results and good management practices is important and that it will take some time to become fully realized. Essential steps are to define, measure and report on results.

The government initiatives to strengthen the management focus on results include: changes in the Expenditure Management System; improved reporting to Parliament; the development of government performance indicators; and modernizing comptrollership.

We look forward to working with the Auditor General to identify good practices and to communicate them to departments, Parliament and Canadians.



About the Study

Objectives

Our objectives were:

- to propose and explain a management framework for encouraging greater progress toward managing for results;
- to identify lessons learned and best practices in moving toward managing for results; and
- to determine incentives and disincentives faced by departments and program managers in adopting a results-based management culture.

Scope

The study looked at progress in moving toward managing for results. We reviewed management practices that create an organizational culture that fosters managing for results, agreeing on expected results, measuring results, using information on results to improve performance and effectively reporting results. We concentrated on cases in several jurisdictions where results-based management practices are in use, or where initiatives are well under way to move toward managing for results. We reviewed their experiences and lessons learned regarding incentives, facilitators or enablers, and disincentives, inhibitors or constraints.

We looked at experiences in five Canadian federal government programs: The North American Waterfowl Management Plan jointly administered by Environment Canada, the Canadian Centre for Mineral and Energy Technology at Natural Resources Canada, the Travellers Program at Revenue Canada, Environment Canada's Department-wide accountability framework and the Investigations and Control Function of the Employment Insurance Program at Human Resources Development Canada.

We also reviewed progress in other jurisdictions, including U.S. federal government agencies complying with the *Government Performance and Results Act* of 1993 on a pilot basis, and progress in provincial or state governments, notably Alberta and a number of U.S. states, and in some local governments.

As this was not an audit, we did not verify the reliability of results information reported by any of the programs or organizations chosen as examples for this study.

Criteria

Because this was a study, we did not compare practices against a predetermined set of criteria. Rather, in conducting the study, we identified a set of principles that constitute a framework for managing for results, and assessed their applicability to the Canadian context.

Approach

We reviewed the relevant literature on the experiences in other jurisdictions, conducted on-site interviews with officials in Alberta; Portland, Oregon; Sunnyvale, California; and Texas, and reviewed related documentation. We conducted interviews with managers in four Canadian federal departments and reviewed related publications and documents. We also conducted interviews with the Treasury Board Secretariat on progress toward managing for results in these departments and on government-wide initiatives related to progress made.

In addition, we drew upon the evidence and findings from the April 1997 audit of Reporting Performance in the Expenditure Management System, conducted jointly with this study.

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Chapter 12 Information Technology: Preparedness for Year 2000



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Chapter 12 Information Technology: Preparedness for Year 2000

October 1997

This October 1997 Report comprises 11 chapters and a Foreword and Main Points. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

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Chapter 12

Information Technology: Preparedness for Year 2000

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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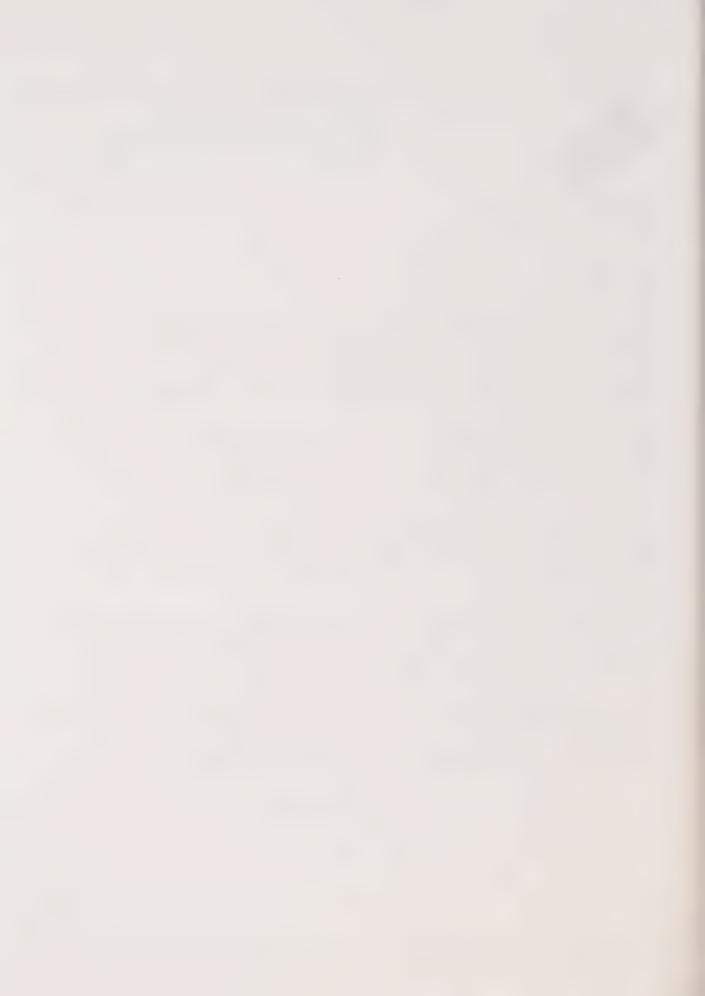


Assistant Auditor General: Doug Timmins Responsible Auditor: Nancy Cheng

Information Technology: Preparedness for Year 2000

Main Points

- 12.1 The "Year 2000" crisis is a global phenomenon. It refers to the potential for systems errors, malfunction and failure as a result of the past practice by computer professionals and the information technology community of representing the year as a two-digit code. Year 2000 can threaten the functioning of government systems that support the delivery of programs and services to the public, as well as internal operations. The costs of dealing with Year 2000 issues have been estimated at as high as US \$600 billion globally. In Canada, total costs are estimated to range from \$30 billion to \$50 billion. The Treasury Board Secretariat has estimated the costs for the Canadian government at \$1 billion.
- 12.2 Year 2000 has been widely recognized as one of the largest information technology projects. The deadline is immovable and the next millennium is less than three years away. We concluded, as of the end of April 1997, that the rate of progress in mitigating the risks of systems errors and failure has generally been slow, and the residual risks are high. In addition, significant exposures such as competing priorities for systems development and insufficient technical resources could, if they materialize, jeopardize Year 2000 efforts.
- 12.3 The Treasury Board Secretariat has helped to raise awareness across government and facilitated the exchange of views and experiences on Year 2000 efforts. Its Year 2000 project office has been working with departments and agencies to identify and find solutions to common problems. The Secretariat advised us that its submission for funding government-wide initiatives was approved in late June for presentation to the Treasury Board during the summer of 1997.
- 12.4 However, if progress were to continue at the rate we observed at the time of the audit, it would likely be too slow to ensure that the government systems, including those that are critical to supporting major programs and essential services, will be ready in time. We are concerned that systems supporting government programs and services remain at risk. Failure of critical systems could affect public health and safety and essential services to the public. In our view, Year 2000 is a serious threat that requires urgent and aggressive action.
- 12.5 We have recommended that Year 2000 projects, including the development of contingency plans, be ranked among top priorities of departments and agencies. In addition, we have recommended that the Secretariat give high priority to its initiative on overseeing the successful implementation of the most critical systems for the government as a whole. We have also emphasized the need for sustained commitment and support from senior management and for continued engagement of ministers, as appropriate, to address exposures and roadblocks that can derail Year 2000 projects.



Introduction

The "Year 2000" crisis

- 12.6 During the past decades,
 Canadians have placed ever-increasing
 reliance on information technology in
 various aspects of our lives. Today,
 businesses depend on information systems
 for continuous operations but, more
 importantly, for competitive advantage
 and business survival. Similarly,
 governments rely on systems to deliver
 programs and services to the public and to
 support operations. The Year 2000 crisis
 threatens those systems on which we have
 come to rely.
- common practice among programmers and computer professionals to represent a year by a two-digit code. Under this practice, the year 1997 would typically be represented as "97". If left unchecked, upon reaching the year 2000 a system could interpret "00" to represent the year 1900. In addition, a system could revert to a "beginning-of-time" date, such as 1980 or the date on which the system was first implemented.
- 12.8 The date code, including the year, is used extensively in systems. In many applications, the date value is used in labelling, sorting, updating and other data manipulation functions. As a result, an incorrect interpretation of the date can play havoc with system outputs and results.
- 12.9 For example, Year 2000 could affect interest calculation on loans and mortgages. Other business applications, such as workload management, could also be affected. These applications often depend on proper sorting of casework by date. Cases beginning in 2000 could be listed as the least current if the year is interpreted to be 1900. Similarly, aging of

accounts for credit and collection purposes could create reports that contain meaningless or inappropriate information.

- 12.10 Further, misinterpretation of dates could generate undefined outcomes, causing transactions to be rejected as errors, or processing to be aborted. It is also possible for the Year 2000 effect to be felt in advance; applications that generate expiry dates could fail well before 2000.
- 12.11 Overall, the consequences of the Year 2000 issue could range from something as innocuous as an incorrect date display on a screen or computer listing to a situation much more severe, such as processing being aborted or erroneous results that may not be readily detected by users.
- 12.12 Year 2000, also known as the millennium bug, century date change, Y2K (a registered trademark) and other variations, is not limited to large-scale, mainframe or older systems. All other systems could also be affected, including recent acquisitions and updates to systems as well as personal computers and work stations that are on the desks of most employees in many organizations. In fact, the threat extends to all micro-processors that support systems and embedded devices, beyond the traditional computer application systems.
- 12.13 The best-known examples are probably elevators and ventilation systems in facilities where system functionality may depend on micro-processors. Other, less obvious examples include bank vaults and components of an automobile that are controlled by computer chips. All of them can be vulnerable to the Year 2000 threat.
- 12.14 An independent research firm has estimated the costs worldwide to address the Year 2000 challenge at US \$300 billion to US \$600 billion. The estimates have been widely acknowledged

Governments rely on systems to deliver programs and services to the public and to support operations.

An independent research firm has estimated the costs worldwide to address the Year 2000 challenge at US \$300 billion to US \$600 billion.

The potential consequences for the government could be manifest as health and safety concerns, financial implications, disruption to essential services for the public or legal ramifications.

within the computer industry and information technology community. The same firm has also predicted that some 90 percent of systems and codes will be affected by Year 2000.

12.15 This challenge comes with some unique characteristics. Most significant, the available time remaining to assess the situation and implement necessary changes is limited; there is no room for flexibility in deadlines or for extension of time. Moreover, Year 2000 transcends all industry and service sectors and has no geographical boundaries. The same project management and technical skills and resources will be needed everywhere at the same time. It is widely anticipated that the demand for these resources will exceed the supply as we get closer to 2000.

Possible effect on government services and operations

12.16 For the federal government, the stakes are high. If systems are not tested and made compliant where appropriate, Year 2000 could threaten the continuous delivery of programs and services. Systems that are critical in supporting major programs and essential services may fail as we approach the next millennium. The potential consequences for the government could be manifest as health and safety concerns, financial implications, disruption to essential services for the public or legal ramifications.

12.17 We prepared the following scenarios to illustrate the potential impact of Year 2000 on government programs and services. The scenarios are hypothetical and are possible only if the systems are not made compliant in time for Year 2000 purposes.

- Systems supporting search and rescue efforts may cease to function properly, which could cause undue delay in emergency situations.
- The Canadian Customs systems may not be able to support commercial cargo clearance and release processes at the border. The impact could be a choice between disruption to businesses and reduced or random inspection without systems support, possibly jeopardizing health and safety or assessment and collection of duties and taxes, which total billions of dollars annually.
- The system supporting the Employment Insurance program may not be able to generate proper payments, which could result in errors or delays in providing relief to beneficiaries of the program.
- The systems supporting the Receiver General functions may fail, which could lead to disruption or delay in paying vendors and suppliers for goods and services provided to the government.
- The system to enforce family orders and agreements may fail to trace and intercept federal payments to individuals who are in default of family support payments. Consequently, it could not redirect the payments to those who are owed the support, causing them financial hardship.

With appropriate and timely action, scenarios such as these can be avoided.

12.18 Many of the systems supporting government programs and applications are older systems that have used two-digit coding for the year. Moreover, these systems often operate in a decentralized environment with numerous interfaces inside departments, across government or with external partners. Decentralization and system interfaces add another complex dimension to overcoming the Year 2000 challenge. These factors, along with the sheer volume of existing systems

in government, the time constraint and a limited supply of technical resources, expose government programs and operations to significant risk from the Year 2000 threat.

12.19 However, the federal government is not alone in its struggle. Businesses and organizations across Canada and other levels of government also face the Year 2000 threat. The information technology community has estimated that Year 2000 efforts will cost \$30 billion to \$50 billion in Canada.

12.20 In the business community, many large firms such as major banking institutions have been actively addressing Year 2000 issues, but many other businesses have yet to begin. In fact, one research firm has predicted widespread business failure as a result of Year 2000. The risks are particularly high for smalland medium-sized businesses, where the potential impact of Year 2000 may not be fully appreciated yet. Should a high rate of business failure occur, it could have a detrimental effect on the Canadian economy, with repercussions on the country's revenue, debt and deficit, and employment and social issues.

Focus of the audit

12.21 The audit examined the risks and exposures as of 30 April 1997 that government programs and operations face as a result of the Year 2000 threat. We reviewed the progress and state of preparedness in mitigating the risks at a number of departments, and initiatives undertaken by the Chief Information Officer Branch of the Treasury Board Secretariat to advance government efforts concerning Year 2000. In addition, we supplemented our audit with a general survey of departments and agencies.

12.22 The purpose of the audit was to provide information to Parliament regarding Year 2000 and to prompt appropriate action to address critical systems and those that concern the interests of the Crown and the public. The audit also sought to identify and highlight issues and areas that require further attention from Parliament and from management in departments and agencies.

12.23 Further information about the audit objective, scope and criteria are in **About the Audit**.

Observations and Recommendations

Senior Management Awareness and Support Visible since Early 1997

12.24 Further to discussions at meetings of the interdepartmental committee for heads of information technology, the Treasury Board Secretariat conducted a preliminary survey in late 1994 to assess the impact of the Year 2000 threat. However, many departments and agencies did not respond and, among those that did, the extent of analysis and information they provided varied widely.

12.25 In May 1996, the Treasury Board Secretariat established a project office within the Chief Information Officer Branch to provide leadership for the Year 2000 issue in government. The project office has been charged with the responsibility to oversee Year 2000 efforts within government and to address horizontal issues. The Year 2000 project office also initiated an interdepartmental working group to facilitate dialogue and to exchange views and experiences in dealing with the Year 2000 threat.

12.26 At that time, the Secretary wrote to heads of all departments and agencies,

Should a high rate of business failure occur, it could have a detrimental effect on the Canadian economy.

The ensuing challenge will be to sustain senior management interest and commitment over time.

asking for information on their risk and exposure with respect to Year 2000, as well as their plans to address the issue. From the responses, the Secretariat's project office concluded that most organizations were not aware of the full scope and implications of Year 2000 for their operations. Many departments and agencies had only begun to study the full ramifications of Year 2000, and about 12 had concluded that the threat would have a significant impact on their operations, with potentially major costs to manage the risks. Further, according to the project office, the responses indicated that while senior management might have viewed Year 2000 as a potentially serious threat, preliminary assessments had since reassured many that the issue would be addressed through normal operations.

12.27 In the fall, the Secretariat assisted in raising the profile of the issue by making Year 2000 a standing item on the agenda of the interdepartmental committee for heads of information technology. The subject also appeared frequently as an agenda item for the information management committee, comprising deputy ministers as members. However, by late 1996, many heads of information technology continued to express concern that senior management awareness and support were lagging.

12.28 In January 1997 the information technology industry, through the Information Technology Association of Canada and the Canadian Information Processing Society, wrote to all deputy ministers to express its growing concern about the millennium date change.

12.29 During the February 1997 meeting of deputy ministers, the Secretary of the Treasury Board presented the Year 2000 issue, providing a checklist and identifying a number of horizontal initiatives.

12.30 At Year 2000 conferences and symposia, it has been widely held that gaining senior management acknowledgment and support is not only essential but critical to the success of overcoming the Year 2000 challenge. While some information technology staff may have started to address the issue, awareness and support of senior management in most departments and agencies became evident only in early 1997. The ensuing challenge will be to sustain senior management interest and commitment over time.

Rate of Progress Has Generally Been Slow

12.31 Generic phases of a Year 2000 project. Organizations, computer professionals and consulting services have defined many models of the phases and stages in a Year 2000 project. Most have the same generic phases; some are categorized in more stages than others.

12.32 We categorized the phases as follows:

- project management structure;
- inventory, assessment and planning;
- conversion; and
- testing and implementation.

12.33 In general, the phases involve establishing a Year 2000 project office to manage the project for the organization. The project office mobilizes the project through fact finding, analysis and planning. The deliverables usually include a strategy and approach, an estimation of resources needed, an action plan with milestones and deadlines, and a contingency plan. The substantive work involves repairing, replacing or retiring existing applications and systems, followed by testing and then implementation. Exhibit 12.1 further describes the four phases.

12.34 While the phases tend to be carried out sequentially, there will be some overlaps. Project management, for example, spans the entire duration of the project.

Project management structures were generally in place

12.35 As described in About the Audit, we selected nine departments and examined the overall progress of their Year 2000 efforts. These departments deliver many of the government's major programs and essential services, such as those outlined in paragraphs 12.16 and 12.17. We also conducted a general survey of over 60 other departments and agencies to gather information on the status of their Year 2000 work. We completed our substantive examinations in April 1997. The findings reflect our assessment of the status of the nine departments as of early May 1997.

12.36 We would expect departments to put in place a formal Year 2000 project management structure to secure senior management awareness and support, and

to manage and contain the risks posed by the Year 2000 threat.

12.37 We found that all nine departments have established a Year 2000 project office. In most departments, the management structures are supported by an organization chart, and all but two have project charters that outline the terms of reference for the project and the relationships among stakeholders.

12.38 The project offices are led by full-time staff, primarily at the manager level. Senior sponsors for Year 2000 projects have been identified and most are at the level of assistant deputy minister.

12.39 We noted that, in seven cases, the senior sponsors are the heads of information systems and technology in their respective departments. The information systems and technology function needs to play a critical role in a Year 2000 project management structure. However, a complete alignment of a project office and its sponsorship with this function may perpetuate the belief that Year 2000 is solely an information technology problem. It has been widely

	t Management Structure
Establis	sh a Year 2000
progran	n management
structur	e. Promote
departn	nent-wide
awaren	ess. Secure
necessa	ry resources and
manage	ment support.
Monito	r progress.
Sustain	management
commit	ment and
support	
-	7

Inventory, Assessment & Planning	Assess the Year 2000 impact on the department. Inventory and assess systems supporting the major programs and operations and prioritize their conversion. Formulate an overall strategy and action plan. Develop contingency plans.
Conversion	Repair, replace or retire selected technology, systems and databases. Modify interfaces.
Testing & Implementation	Validate repaired or replaced systems and interfaces for Year 2000 compliance. Test the performance, functionality and integration of technology, systems, databases and interfaces in an operational environment. Implement repaired or replaced systems and technology. Implement contingency plans and work-around arrangements as necessary.

Exhibit 12.1

A Year 2000 Project Model

held by the information technology industry that identifying Year 2000 as an information technology problem rather than a business management issue is a main obstacle in securing senior management awareness.

- 12.40 In one department, the information technology function issued a Year 2000 warning in June 1995 and requested that all branches submit a systems inventory; systems operation in that department is decentralized and is managed by individual program branches. Several submissions were received but were found to be inadequate. In July 1996, a working group was formed to raise awareness of the Year 2000 issue among branch management. In August, the head of information technology again requested an application inventory from the branches. In February 1997, the departmental management committee was briefed on Year 2000 and on progress in the department. The department formally established a project management office in April 1997. As of the end of April, the department had yet to complete its systems inventory and impact analysis with respect to Year 2000.
- 12.41 Further, there is a risk that the systems supported centrally by the information technology function could be emphasized over other systems that may also be essential in supporting programs and services delivered by the departments.
- 12.42 In general, we observed that the assessment and project plans for systems that support corporate services were more thorough and better documented than those for other systems. As an illustration, in one department we found that detailed plans were prepared for corporate systems. In contrast, there was limited information on applications and systems at the program branch level. As of the end of

- April, the identification and assessment of such applications and systems in that department had just begun. While the corporate systems are essential to support internal operations, many of the systems in the program areas are critical to sustaining program and service delivery.
- 12.43 We found the risk to be higher where the Year 2000 project management structure, including the senior sponsor, is part of the information technology function of the department and where systems operations are decentralized and controlled by program branches.
- 12.44 We noted that most departments we examined have used cross-functional committee structures to complement Year 2000 project offices. We found this practice to be an effective way to engage program branches, especially where more senior staff from these branches participate. However, as of the end of April, we had noted very few cases where Year 2000 project status and decisions had been brought to heads of departments for consideration.
- 12.45 We received about 50 responses to our general survey. About 70 percent of these responses indicated that a management structure for the Year 2000 project has been established. Of those organizations, about half showed that committee structures are being used, with regular briefings to senior sponsors.
- 12.46 In addition to managing one of the largest information technology projects, Year 2000 project teams in general face an important challenge in gaining and maintaining senior management support and commitment. In the absence of relentless efforts to engage departmental executives on an ongoing basis, the probability of success for Year 2000 projects will be greatly compromised.

Assessment of critical systems still in progress

12.47 An inventory of systems serves as the basis for establishing the nature and magnitude of a Year 2000 project. It is therefore essential that the inventory be complete and include all systems, from components and modules of application systems to infrastructure and platforms that support the systems and processors that control various devices and facilities.

12.48 We found that all nine departments had completed an inventory of their corporate systems. Seven departments were in the process of completing a departmental inventory for use in impact analysis. In two of the nine departments, however, computer-controlled devices and facilities were explicitly excluded from the Year 2000 project mandate.

12.49 During this phase, project offices are expected to analyze the potential impact of systems failure as a result of the Year 2000 threat. Based on the impact analysis, project offices are to assess and assign priorities and prepare a strategy and an action plan to address the problem.

12.50 Of the nine departments, we found that three had identified and granted priority to systems that are critical to their program delivery. Five departments were in the process of assessing the criticality of systems. In the remaining department, plans were at a general level and there were no documents identifying its critical systems.

12.51 Analyzing and ranking critical systems are important steps in a Year 2000 project. The prioritization allows efforts and resources to be devoted first and foremost to the critical systems. In the event that time or resources do not permit the conversion of all major systems,

critical systems would be the first to be preserved.

12.52 The results from our general survey were generally consistent with those in the departments we audited. Only 37 percent of the departments and agencies that responded indicated that they had completed an inventory and assessment of their systems.

Most departments examined were at various stages of planning

12.53 We found that three departments had adopted a strategy for conversion. One department was in the process of piloting solutions. Another department has adopted an outsourcing strategy. Two other departments were completing general planning and scoping; one of those had started to conduct detailed analysis of application systems and available tools and solutions. The two remaining departments were developing plans to address Year 2000.

Some Year 2000 plans of the departments we examined were general; some contained more details and specificity in scoping the magnitude of the Year 2000 work. It is evident that those with detailed plans have more rigorous support for estimating efforts and resources needed for the Year 2000 project. We noted that some departments used executable lines of code in major applications as a basis for estimating the necessary effort. Two departments used the function point analysis technique to quantify the extent and complexity of conversion work required. The more detailed information a project office has on the systems inventory, the less room there will be for surprises and cost escalation at a later stage.

12.55 We would expect plans to include timetables and milestones for Year 2000 work and an overall cost estimate. Time

We found that all nine departments had completed an inventory of their corporate systems.

schedules and milestones establish a reference point against which a project office can monitor progress. Cost estimation is necessary to quantify the resources needed to address Year 2000. It also serves to determine whether the organization's internal resources are sufficient for the tasks or whether it needs to request incremental funding.

12.56 We found that detailed time schedules existed in five departments. A sixth department had time schedules for its pilots and activities in the near term but not at the project level. The detailed schedules and milestones are important tools for Year 2000 project managers. Slippage and changes can then be identified and corrective action taken to keep the project on course for completion before 2000.

12.57 Given that the departments were at various stages of planning, not all had completed cost estimates for the Year 2000 project. We noted that some departments used general estimates; others based their estimates on the number of lines of code or on other measures. One department prepared estimates only for the upcoming fiscal year or immediate pilots. Another department prepared costing on the basis of incremental funding. These are funds that are over and above the approved departmental budget and that are necessary to carry out the project.

12.58 As of the end of April, some plans had not identified the major systems interfaces with other departments and outside organizations. Systems interfaces represent a major exposure to the Year 2000 threat. An inability to anticipate date format and to exchange data can significantly curtail the functionality of systems.

12.59 Departments that have project charters and plans have indicated to us that these planning documents have been presented to senior management. However, with one exception, none have been formally endorsed or approved.

12.60 As noted earlier, securing and sustaining senior management support and commitment are essential for success. Seeking the endorsement of senior management for Year 2000 plans and engaging it early in recognizing potential resource requirements are ways to involve management from the start. This practice is particularly important in departments that are using a decentralized approach to managing the Year 2000 project. In a decentralized setting, individual branches and system owners may assess the criticality of their systems and develop and implement their plans independently of one another. In addition to playing a co-ordinating role, a project office needs to engage senior management to ensure that systems that are critical to the department as a whole are accorded the highest priority.

12.61 Our general survey of all departments and agencies showed a similar status. Two thirds of those that responded indicated that they have yet to complete the planning phase. The survey instrument requested a copy of the inventory, assessment and plan where these activities were complete. Of the 18 departments and agencies that indicated completion, only 4 forwarded a copy of the documents to us.

Few departments among those audited have started code conversion and modifications

12.62 Through the planning phase, departments may decide to repair, replace or retire their systems to counter the Year 2000 threat. Where it has been determined that an application will be

Given that the departments were at various stages of planning, not all had completed cost estimates for the Year 2000 project.

converted through repair, the affected program codes will have to be identified and modified.

- 12.63 Two departments advised us that code identification and repair work have been taking place for a number of years as part of regular systems maintenance. One department in particular has been conducting the necessary repair work through its maintenance program for over five years.
- 12.64 However, of the nine examined, we are aware of only two departments that have started program code conversion and modifications as a result of Year 2000 plans. Only one of those two was able to demonstrate progress in conversion work and presented documents for our review. The remaining seven departments have yet to commence the conversion phase of their Year 2000 project.
- 12.65 The Year 2000 plans from most of these departments also call for the replacement of existing non-compliant systems. Some departments have been developing the replacement systems; others contemplate acquiring and implementing third-party products. Most of these systems are large-scale and complex in nature.
- 12.66 Based on experience with past audits of systems under development, we are concerned that some of these replacement systems may not be implemented in time to counter the Year 2000 threat. As noted in past audit reports, historically only 16 percent of systems were delivered on time and within budget.
- 12.67 We noted that three departments have identified specific deadlines and milestones for these development projects. Should the milestones not be met, "drop dead" dates have been established to begin repair work on existing non-compliant

systems. These dates have been established as the earlier of:

- the latest milestone date that will allow the new system to be in place before 2000; or
- the last start date possible for repair work on existing systems for implementation by 2000.
- 12.68 In our opinion, where existing systems can be repaired, it is essential to establish contingency dates and to carefully monitor the progress of projects where critical systems are to be replaced, in order to manage risks associated with systems development.

Residual Risks for Departments and Agencies Remain High

Present rate of progress would likely be too slow

- 12.69 Our examination of the nine departments showed that, as of the end of April 1997, most of them had not progressed beyond planning to converting their systems. Our general survey of other departments and agencies showed a similar status. With two years and eight months remaining, the race against time is on.
- 12.70 The generic phases outlined in Exhibit 12.1 are necessary steps in every Year 2000 project. While there may be enough time to convert systems, sufficient and appropriate testing will likely be at risk.
- 12.71 In setting out the stages of Year 2000 projects, independent research firms have also estimated the proportionate levels of effort and of resources associated with each stage. Exhibit 12.2 sets out the estimated proportion of resource use for the generic phases, as proposed by two research firms.
- **12.72** The exhibit shows that the testing and implementation phase takes

We are concerned that some of the planned replacement systems may not be implemented in time to counter the Year 2000 threat.

While there may be enough time to convert systems, sufficient and appropriate testing will likely be at risk.

54 to 60 percent of the total level of effort, exceeding the inventory, assessment and planning phase and the conversion phase combined. When we completed our audit, most departments and agencies were in the process of completing the inventory, assessment and planning phase, and only a few had started conversion. Consequently, the federal government could yet face undertaking 65 to 90 percent of the total effort needed to overcome the Year 2000 challenge.

12.73 The information technology industry recommends that organizations have all compliant systems implemented by the start of one full business cycle in advance of 2000. The purpose is to allow for time to correct any unanticipated problems before the production cycle enters the next millennium. This practice is being followed by many private sector companies that are actively countering the Year 2000 threat.

12.74 The fiscal cycle for the government begins in April. Thus, to allow for one full fiscal cycle to address unanticipated issues, departments and agencies would need to target implementation for 1 April 1998.

12.75 Two of the nine departments examined have set the target date for full implementation at 1 April 1998. Five organizations that responded to our general survey also indicated that full implementation will be in place by that date. Of those organizations that responded to our general survey, only 35 identified target implementation dates. Exhibit 12.3 shows the range of implementation dates identified by departments and agencies.

12.76 We are concerned that the rate of progress of Year 2000 work may not allow for sufficient testing of systems and that, after the systems are implemented, there may be limited opportunity to correct any

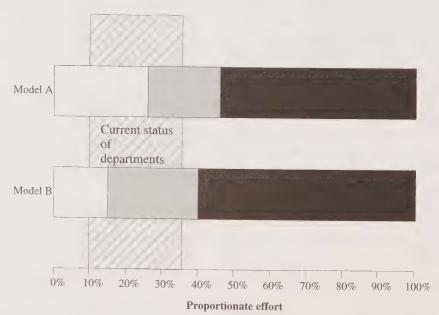


Estimated Proportion of Total Resources Used in Each Phase

Inventory, Assessment & Planning

Conversion

Testing & Implementation



The status was determined based on the audit of nine departments and the results of the general survey conducted by the Office. The models were prepared based on the proportion of resource utilization in each phase, as estimated by two research firms.

unanticipated errors before the year 2000. In our view, the residual risks for departments and agencies remain high. With less than three years to go, we are concerned that if progress continues at the existing rate it will likely be too slow to counter the Year 2000 threat effectively.

Contingency plans need to be developed

12.77 The Year 2000 plans and schedules of the departments have not provided for slippage. Thus, delays or failures in meeting milestones could result in a further compression of the testing and implementation phase or in failure to implement systems prior to 2000.

12.78 At conferences and symposia on Year 2000, the concept of systems triage has been raised — that is, where it has been determined that not all systems can be salvaged in time, priority ought to be given to those that would benefit most from the remaining time and resources. In the Year 2000 context, top priority needs to be assigned to systems that are critical to an organization's business lines or program mandate.

12.79 In general, the departments examined have been planning to carry all systems into the next millennium and have deliberately not been contemplating triage. Given the amount of work involved in Year 2000 projects, the immovable deadline and the early stages of progress in general, systems triage may become necessary for some departments and agencies.

12.80 Indirectly, a form of systems triage has been applied in some larger departments. We noted that some departments applied less rigour in identifying for inclusion in their inventory small administrative and operational systems, such as those developed and maintained locally in regions, and end-user applications at the desktop. In those departments' view, the risk and thus the priority are lower for these systems and applications. The departments indicated that these systems and applications tend not to be critical to departmental programs and operations and, should they fail, could be replaced more readily and expeditiously.

With less than three years to go, we are concerned that if progress continues at the existing rate it will likely be too slow to counter the Year 2000 threat effectively.

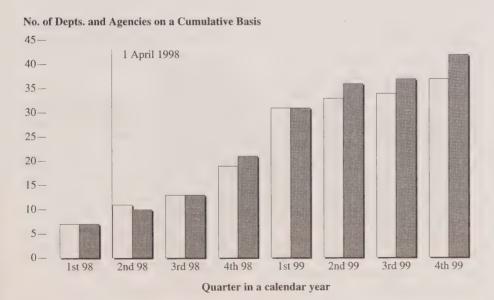


Exhibit 12.3

Target Implementation Dates for Year 2000 Projects

Critical Systems All Systems

Source: Data gathered from departments examined and responses to the general survey conducted by the Office If triage were to be applied, it would be essential for a project office to engage senior management to ensure that the decisions made would best serve the organization and its program recipients.

In our view, Year 2000 contingency plans need to be developed and ought to be completed with sufficient lead time for implementation, if needed, before 2000.

- At the conclusion of the 12.81 inventory, assessment and planning phase, some departments and agencies may find that there is insufficient time to convert all systems. Slippage could occur during conversion and testing and could cause project offices to re-evaluate the viability of some systems upon entering the next millennium. These circumstances may force triage upon an organization. If triage were to be applied, it would be essential for a project office to engage senior management, including the head of the department or agency, to ensure that the decisions made would best serve the organization and its program recipients.
- 12.82 With or without triage, it would be prudent to plan for the possibility that some systems, upon reaching 2000, may not continue to function as designed. Therefore, we would expect departments and agencies to develop contingency plans.
- 12.83 As noted in paragraph 12.67, some departments have developed first-level contingency plans, by establishing "drop dead" dates to start repair work on existing systems should the development of their replacements fail to meet key milestones by those dates. Staff from some departments indicated that contingency planning has been under initial discussion. However, none of the nine departments have started preparing substantive contingency plans for their systems. In the general survey, three organizations indicated that they have prepared Year 2000 contingency plans. Although the plans were requested in the survey instrument, we received none.
- 12.84 Many organizations may have various forms of disaster recovery plans and backup systems in place. However, it is unlikely that these measures alone will be sufficient in the event that systems fail as a result of Year 2000.

- 12.85 In general terms, many such measures anticipate disaster striking and rendering systems not functional for a period of time, until they are replaced or put in order. In the meantime, processing could continue at an alternative site with backup systems and data files. However, it could take months or longer for some Year 2000 conversions and implementations to be completed, and there are no backup systems and files that could help to support programs and operations in the meantime.
- The preparation of Year 2000 12.86 contingency plans can be time-consuming and onerous. Departments need to develop work-around arrangements and decide how they would be implemented. The arrangements may involve changes in staff deployment. Interim procedures and additional verification of output data may have to be developed. Staff training may be required to introduce these procedures and verification. Furthermore, there may be a need for a communication plan to inform staff, users of the program and services and other stakeholders to gain their acceptance of the changes and allow for a proper transition.
- 12.87 In our view, Year 2000 contingency plans need to be developed and ought to be completed with sufficient lead time for implementation, if needed, before 2000.

The Treasury Board Secretariat found that problems require more attention at many larger departments

- 12.88 The Year 2000 project office of the Treasury Board Secretariat undertook a survey of departments and agencies in early 1997. In March 1997, the survey instrument was sent under the Secretary's signature to all departments and agencies, seeking the following information:
 - status of Year 2000 activities:

- identification of critical systems;
- identification of external interfaces and system dependencies;
- incremental funding required for Year 2000 by fiscal year; and
 - human resources requirements.

12.89 The survey instrument included detailed appendices to provide guidance to departments and agencies on elements to consider in costing Year 2000 efforts, and on factors to help determine the criticality of systems. The survey was to be completed and returned to the Secretariat by 30 April 1997. In conjunction with the survey, the project office conducted interviews at about 80 departments and agencies, primarily during March and April 1997.

12.90 Through its survey responses and interviews, the Secretariat's project office assessed the state of Year 2000 work at 70 departments and agencies (Exhibit 12.4). The project office observed that, overall, 75 percent of these organizations had the situation under control or had adequate Year 2000 projects in place. The assessment further

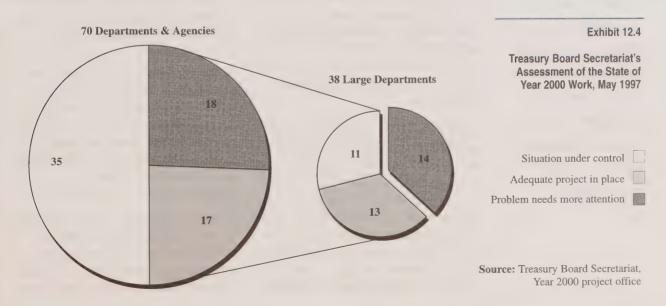
highlighted that 14 larger departments and agencies were in a state of "requiring more attention". The project office also noted that the most critical systems for the government are in the larger departments. The Secretariat advised us that its Year 2000 project office plans to focus its attention on these departments.

Significant exposures still ahead

number of significant exposures to risks. They loom over the Year 2000 project and have the potential to derail an already tight time schedule for most departments and agencies. We identify five of them in the following paragraphs.

12.92 Competing priorities and developments. Information systems and technology functions at departments and agencies are often faced with demands for changes to existing systems and implementation of new systems through internal development or commercial off-the-shelf products. Such demands compete with Year 2000 projects for the same limited resources.

12.93 Some of the demands for change arise from existing program or operational



The inability to secure sufficient technical resources to carry out a Year 2000 project is probably one of the most serious concerns to senior information technology officials.

needs; others may be driven by government-wide initiatives. Still others could be a result of legislative or other promulgated program changes. While some senior managers may be aware of the exposure to risks, senior management in all departments and agencies needs to be made fully aware and to commit to keeping other systems development work to a minimum.

12.94 Where other development work needed for government-wide initiatives or legislative and program changes threatens Year 2000 projects, senior management may have to request a delay in implementing the initiatives or seek legislative reprieve, if necessary.

12.95 Insufficient technical resources. The inability to secure sufficient technical resources to carry out a Year 2000 project is probably one of the most serious concerns to senior information technology officials. Departments and agencies can be affected in one of two ways.

12.96 Internally, they may face the risk of losing key technical staff to outside organizations. As opportunities increase for technical expertise to deal with Year 2000, compensation and remuneration in the private sector become more attractive to skilled individuals, making it increasingly difficult for departments and agencies to retain key technical staff.

12.97 There is also a risk that, as we approach 2000, private sector firms may not be able to continue to supply sufficient computer professionals to repair or replace systems, regardless of contract rates offered. Since Year 2000 is a global issue that affects and has the same deadline for all organizations, the demand for expertise is likely to exceed the supply as time passes. Some computer professionals have

predicted that this will start no later than late 1997.

12.98 As we concluded our audit in early May, officials in some departments advised us that a higher than usual rate of turnover of computer staff has begun. The news media also reported that compensation for these professionals has started to rise.

12.99 On an ongoing basis, senior management needs to be kept apprised of how its department or agency is being affected. Departments and agencies may need to call upon the Treasury Board Secretariat to help address this risk.

12.100 Failure or delay in obtaining compliant upgrades from vendors.

Third-party vendors supply numerous products to departments and agencies. They range from processors and devices to operating and application systems. Many of these products are not compliant for Year 2000 purposes, including, possibly, acquisitions made in recent years.

12.101 Many vendors have indicated that new versions and upgrades will be compliant and will be released at some future date. Some have yet to reply to queries from departments and agencies on the status of their products, or on whether and when some future upgrades will become compliant.

12.102 To control this risk, Year 2000 project offices need to leave sufficient time to acquire alternative compliant products should vendors fail to meet announced release dates. Depending on the implications of the specific exposure, it may need to be included in the contingency plan.

12.103 Data interface exposure. Many systems interface with one another to provide functionality to groups of users. Albeit that arrangements can be made in advance for the mode and format of data

To control the risk, Year 2000 project offices need to leave sufficient time to acquire alternative compliant products should vendors fail to meet announced release dates. transfer, errors can occur and some partners could fail to make the changes in time.

12.104 The extent of dependency on other systems varies from system to system. In addition to internal interfaces, many systems in departments and agencies interface with those of other departments, other levels of government and external partners. The impact could range from rejecting a limited number of transactions that can nevertheless be rekeyed, to compromising the integrity of the recipient organization's data files.

12.105 Repairs of all necessary linkages have to be co-ordinated and made. For interfaces involving other government organizations and external partners, Year 2000 project offices need to be vigilant in confirming Year 2000 compliance prior to mutually agreed changeover dates and allowing sufficient time for testing. If a transfer of non-compliant data could be severely detrimental to departmental systems, the project offices may have to explore "what if" scenarios and include them in their contingency plans.

12.106 Risk of funding delay. As reported earlier, many departments and agencies have yet to complete cost estimates for the Year 2000 project. Without meaningful information on overall funding requirements, it would be difficult to ascertain what shortfall from existing systems maintenance budgets might arise and, in turn, for senior management to determine if it would need to request incremental funding beyond departmental budgets.

12.107 As we have noted, the costs for Year 2000 will be significant. As of early May 1997, the Treasury Board Secretariat estimated \$1 billion as the overall cost of making government systems compliant for

Year 2000. It was anticipated that some departments may request significant incremental funding, potentially totalling hundreds of millions of dollars.

12.108 There is a risk that tasks and action on the Year 2000 project would be delayed if funding commitment were not to be secured on a timely basis.

12.109 With or without submissions to the Treasury Board for incremental funding, senior management may have to be prepared to fund Year 2000 projects internally to ensure that they do not sustain undue delay.

Aggressive Government-wide Action Is in Order

Need to rank Year 2000 among top priorities

12.110 The Secretariat has been actively raising awareness of Year 2000 across government. The interdepartmental working group set up and chaired by its project office has provided a forum for discussing views and exchanging experiences in Year 2000 work. Through its surveys, the working group, and other interdepartmental committees involving heads of information technology and deputy ministers, the Secretariat has played a meaningful role in co-ordinating and facilitating Year 2000 issues.

12.111 However, we observed as of April 1997 that the government's rate of progress against Year 2000 has generally been slow, and the majority of the total effort required has yet to be undertaken. We have also concluded that the Year 2000 risks facing departments and agencies remain high.

12.112 The amount of work still required is staggering, and the time remaining is limited. Computer professionals have often used an average number of systems

There is a risk that tasks and action on the Year 2000 project would be delayed if funding commitment were not to be secured on a timely basis.

We are concerned that many systems that are critical to supporting government programs and services are at risk. or components that need to be converted, tested and implemented every week as a reminder of the magnitude of the task at hand in relation to time that remains.

12.113 The data we gathered from the audit and our general survey showed that the target implementation date of 1 April 1998 will not be attainable for most departments and agencies. Our discussion with private sector experts indicated that 1 January 1999, which allows one calendar year for delays and unanticipated problems before 2000, is emerging as the industry standard as the last day to fully implement Year 2000-compliant systems. At the end of our audit, only 20 months remained before that date. It is not uncommon for departments and agencies to have to address hundreds of modules, components and systems for Year 2000 purposes. Assuming an inventory of 100 potentially affected systems or components, an organization would have to analyze and test, and possibly convert and implement, an average of five systems or components per month, or at least one per week on a continuous basis, to meet the Year 2000 schedule.

12.114 Moreover, we observed that substantive contingency plans have not been developed and that exposure to many significant risks could derail Year 2000 projects.

12.115 We are concerned that many systems that are critical to supporting government programs and services are at risk. The rate of progress that we observed would likely be too slow to assure continuous systems support for the delivery of these programs and services. The government needs to rank Year 2000 as one of its top priorities and develop contingency plans. There is a need for urgent and aggressive government-wide action. Subsequent to the audit, the Treasury Board Secretariat advised us

that, in its view, the government's rate of progress has been accelerating and aggressive action is under way.

12.116 As noted earlier, the ability of a departmental Year 2000 project office to elicit sustained commitment and support from senior management throughout all of the phases is critical to the success of the project. From our examination of the nine departments, we identified several matters that merit attention from senior management. Exhibit 12.5 provides a sample of these matters.

12.117 In particular, at those larger departments and agencies with critical systems and where the Secretariat has determined that the Year 2000 problem requires more attention, the Secretariat needs to ensure that senior management in each of those organizations is engaged on an ongoing basis in addressing the problem.

12.118 Departments and agencies should rank Year 2000 projects among their top priorities and develop contingency plans. Senior management should provide support to the Year 2000 effort on an ongoing basis and should address roadblocks and exposure to risks as they arise.

12.119 The Treasury Board Secretariat should assist departmental efforts by continuing to engage senior management of departments and agencies in sustaining commitment and support for Year 2000 projects.

Need for a government-wide perspective

12.120 The government delivers its programs and services to the public through many departments and agencies. The departments and agencies are at various stages in their Year 2000 projects and have different capacities to address the issue. Further, while individual

departments and agencies are addressing systems that are critical to their own programs and operations, it is also important that specific attention be given to systems that are most critical to the government as a whole.

12.121 Collectively, the government needs to identify and assign priority to a manageable number of systems that are most critical to supporting major programs and essential services, and to charge a specific group to oversee their successful Year 2000 implementation. These are systems that can have significant consequences in such areas as health and safety, financial implications, public interest and hardship, and legal issues.

12.122 The Secretariat's Year 2000 project office has a mandate to oversee Year 2000 efforts across government. It advised us that its work plan includes an

initiative to monitor the state of readiness for all mission-critical systems. It indicated that the initiative calls for updates of departmental progress in September 1997 and January 1998, but the means through which the information will be collected and analyzed have yet to be developed.

12.123 Departments and agencies would continue to be responsible for these systems as part of their Year 2000 projects. In our view, the oversight role would be primarily to ensure that the schedule and milestones are in place, and that they allow for sufficient testing of the applications and for time after implementation to correct any detected errors before 2000. The oversight role could also include ensuring that contingency plans would be developed for these systems. On an ongoing basis, the Secretariat's project office would monitor

Collectively, the government needs to identify and assign priority to a manageable number of systems that are most critical to supporting major programs and essential services.

Demand regular progress report on Year 2000, ask frequently. Most departmental management committees meet weekly. Senior management should demand progress reporting on at least a monthly basis, and more frequently if slippage occurs or when key milestones approach.

Seek assurance that all significant programs and operations are included and ranked appropriately. Senior management should seek assurance that all branch heads have satisfied themselves about the completeness of systems inventory for Year 2000 purposes. It should approve the prioritization and ensure that it is done in accordance with program significance and potential Year 2000 impact.

Involve internal audit and evaluation as a source of assurance. Many departments that we examined have involved internal audit and evaluation as part of their Year 2000 projects or as an independent process. Departments should use the internal audit and evaluation function as a source of assurance. This could involve ensuring the completeness of inventory, progress according to plan and schedule, completion of milestones, and fulfilling quality assurance functions.

Secure department-wide support in event of systems triage. Where systems triage becomes inevitable, senior management should ensure that there is corporate support for focusing on the chosen systems. Senior management should be satisfied that the decision would best serve the interests of the department and its program recipients.

Call for contingency plans. Senior management should ensure that contingency plans are developed. Where implementation of the plan is necessary, sufficient lead time should be allowed.

Monitor potential roadblocks and exposures and address them if they materialize. There can be many roadblocks and exposures that could jeopardize the Year 2000 project. Some could affect many departments; some could be specific to a department. Senior management should remain on guard and be prepared to address them, at the departmental level or working with other departments and central agencies, if they arise.

Exhibit 12.5

Sample of Matters Requiring Support and Commitment from Senior Management progress for these systems and intervene strategically as appropriate.

12.124 Where systems in more than one organization interact to support a program, the Secretariat's project office would have the additional role of ensuring that all related systems and applications were identified and monitored. The functionality of these systems could be significantly curtailed if some component systems were not converted and implemented in time.

Support from ministers could be invaluable in overcoming roadblocks and exposures that may materialize later.

12.125 Subsequent to the audit, the Secretariat advised us that within its initiative of monitoring Year 2000 in government, it plans to focus its attention on the most critical systems. Its project office further indicated that an initial list of such systems has been prepared and is under review internally.

12.126 The Treasury Board Secretariat should place high priority on its monitoring initiative, in particular, its effort in identifying and overseeing a manageable number of the government's most critical systems. It should intervene strategically as appropriate to ensure their successful implementation before 2000. This should include the development of related contingency plans to ensure continuous systems support for major programs and essential services into the next millennium.

A role for ministers and Parliament

12.127 Given the potential significance of the issue, we would expect ministers to be engaged in the Year 2000 challenge and Parliament to be kept informed of the issue and its potential effects on government programs and service delivery.

12.128 In examining the departments, we were not able to confirm that any briefings had been given to ministers. At the Secretariat, its project office had been preparing a presentation since early 1997 to inform Treasury Board ministers of Year 2000 and to seek funding to manage a number of related government-wide initiatives.

12.129 In late June, the Secretariat advised us that a submission had been approved for presentation to the Treasury Board ministers during the summer of 1997. The Secretariat further indicated that a second submission would be made in the fall to advise Treasury Board of the state of the government's preparedness for Year 2000 and the estimated related costs.

12.130 In our view, ministers ought to be enlisted to support the Year 2000 initiative. Their support could be invaluable in overcoming roadblocks and exposures that may materialize later. Furthermore, Parliament ought to be kept informed of this impending threat and the government's progress in countering it.

12.131 Departments and agencies should engage ministers on a timely basis, to advise them of the urgency of the Year 2000 threat to government programs and services and to gain their support in overcoming roadblocks and exposures that may arise. The Treasury Board Secretariat should continue to involve Treasury Board ministers and advise them periodically of the government's progress in managing Year 2000 projects and government-wide initiatives.

12.132 The government should keep Parliament informed of Year 2000, the potential impact on government programs and services and its progress in making systems compliant for Year 2000.

Opportunities Exist to Gain Efficiency

12.133 The primary focus of Year 2000 projects is to control the risks of systems errors and failures that could disrupt or jeopardize government programs and services to the public. At the same time, opportunities exist to gain efficiency in Year 2000 efforts across government. Acting on some of these opportunities can counter some of the exposure to risks we have identified; acting on others can help reduce duplication of effort among departments and agencies. We would expect that in countering the Year 2000 threat, initiatives would be undertaken to address common issues across government in order to maximize cost effectiveness.

12.134 Since the establishment of the Year 2000 project office at the Treasury Board Secretariat in 1996, efforts have been made to identify issues that can be managed horizontally to benefit all departments and agencies. Through establishing an interdepartmental committee, the group has been identifying horizontal issues and developing a work plan to address them.

12.135 The Secretariat intended to present the Year 2000 issue to Treasury Board ministers in March 1997 to seek endorsement and approval of funding for the work plan. As we completed our audit in early May, the Secretariat was in the process of revising its presentation and preparing the Year 2000 work plan. In late June, the Secretariat identified 12 government-wide initiatives and their related funding requirements and a list of 6 challenges. The initiatives and their funding requirements were subsequently approved for presentation to the Treasury Board.

12.136 We note in the following paragraphs some issues that, in our view,

merit particular attention on a government-wide basis.

12.137 Shortage of technical resources. Retention of key staff is an area of exposure for many departments. The larger departments that conduct a significant portion of systems development in-house are particularly at risk. Private sector firms have started deploying special strategies to retain their own key technical staff for the duration of their Year 2000 projects. The nature of the issue calls for a government-wide initiative.

12.138 The Secretariat facilitated a working session with departmental representatives in May to discuss human resource issues and to identify options for retaining staff. It advised us that the Chief Information Officer Branch has also developed an action plan for managing human resources in the information technology community, and that the plan includes needs that relate directly to Year 2000 as part of La Relève, an initiative to address human resource issues in government.

12.139 General concern has also been expressed about the length of the procurement cycle. Full procurement cycles can take six to nine months to complete. The longer the cycle takes, the lower the possibility of engaging appropriate contractors and the higher the cost for their services. The Secretariat indicated that an interdepartmental group was being formed to review the procurement process and address this means of securing technical resources.

12.140 Vendor compliance. All departments and agencies require information on the state of compliance of existing versions of vendor products and the monitoring of development of future compliant releases. Efficiency can be gained by tasking a single group to

Through establishing an interdepartmental committee, the group has been identifying horizontal issues and developing a work plan to address them.

communicate with vendors and monitor future development.

12.141 In 1996, a procurement group of one department started developing a repository of vendor product information. It has since been determined that more specific information will be required. At the time of our audit, that effort was being continued by another group, adding specific information on the products as they relate to various operating environments that the department supports. Resources needed to broaden the base to all departments and agencies and to share the information with them had been estimated and were awaiting approval.

There would be merit in seeking vendor or third-party certification for the systems to be shared across government.

12.142 Shared systems certification. A number of systems in administrative areas such as financial management and human resources have been identified as ones that will be shared across government. Since these systems will be implemented in more than one department, efficiency can be achieved by ensuring once, for all users, that the applications are compliant for Year 2000 purposes.

12.143 The Secretariat commissioned a review of these systems in early 1997 and reported that many of the applications were or would become compliant for Year 2000. The review also identified areas where the infrastructure and work station environment require changes in order for the shared systems to remain functional in 2000.

12.144 The review was not intended to and did not include validation of the commercial applications. To serve departments and agencies and allow them to focus on their own information technology infrastructure and environment, there would be merit in seeking vendor or third-party certification for the applications.

12.145 Date standards. Various date standards exist in the information technology industry and there are many Year 2000 solutions. The subject of establishing a single standard has been debated within the information technology community.

12.146 A date standard has been in place in the Treasury Board Information Technology Standards since 1988. If the date standard had been followed by departments and agencies, system interfaces internal to the government would pose a lesser threat as a result of Year 2000. However, decreeing a standard for immediate adoption could jeopardize many Year 2000 projects already under way in departments and agencies. There would be merit in the government's promulgating established standards as a target for adoption in the longer term.

12.147 Test facilities. Departments and agencies need to plan ahead for the testing phase. There will be a need for a Year 2000 test environment, separate from a production environment. Many departments and agencies will not have excess processing capacity to create such test environments. There could be duplication in the use of resources if all departments and agencies were to acquire additional capacity for testing. Through testing applications and data files at central facilities, experience could be gathered to benefit other departments and agencies.

12.148 There would be merit in exploring the feasibility of creating test facilities that could serve some departments and agencies. The Secretariat's project office has identified as one of its initiatives a study of the feasibility of establishing a common test facility.

- **12.149** Legal implications. As of May 1997, analysis of the legal implications of Year 2000 had been primarily in the area of contracting and contract administration.
- **12.150** Limited work has been done to examine and analyze other possible legal implications for the government that may result from Year 2000. Possible scenarios to consider include:
- errors in government services and information upon which businesses or the public rely;
- interruption in services that result in delays, causing loss of business;
- malfunction of products or devices certified by the government; and
- defects, errors, interruption or failure of goods or services regulated by the government.
- 12.151 In our view, there would be merit in conducting legal analyses so that departments and agencies can receive guidance and advice on precautionary measures to take as appropriate. In late June, the Secretariat's project office identified legal issues arising from Year 2000 among its list of challenges for consideration.
- 12.152 Most of these opportunities and many others have been identified by the Secretariat. However, as of early May 1997, some initiatives were under way and others had yet to be started. In addition, no initiatives relating to date standards and legal implications were included in the proposed activities. If the opportunities are not pursued expeditiously, the centralized effort will lose its potential to serve departments and agencies.
- 12.153 The Treasury Board Secretariat should accelerate its work plan for Year 2000 and launch or expedite the

projects in the plan. It should also assess the merit of initiatives concerning date standards and legal implications for inclusion in its work plan.

Conclusion

- 12.154 The Year 2000 issue can have a significant adverse effect on government programs and operations. The stakes for the government are high. In particular, systems that are most critical in supporting major programs may fail and could affect public health and safety and other essential services to the public. Aside from the direct fallout of systems errors or failures, Canadians' confidence in the public service may also be at stake.
- 12.155 Our audit of departments and our general survey showed that, as of the end of April 1997, most government departments and agencies were at early stages of their Year 2000 projects. We concluded that the rate of progress to date has generally been slow and that the residual risks to government systems remain high.
- 12.156 The present state of the government's readiness for Year 2000 is particularly vulnerable, given that there is limited time left to convert, test and implement systems. Using the emerging industry standard of allowing one calendar year for addressing delays and unanticipated problems, the government had only 20 months remaining at the time we completed our audit, and the magnitude of the task at hand can be overwhelming. Furthermore, there are formidable exposures ahead that can jeopardize the successful implementation of compliant systems, and substantive contingency plans have yet to be developed.
- **12.157** We are concerned that if progress were to continue at the rate we observed, it would likely be too slow to overcome

If the opportunities are not pursued expeditiously, the centralized effort will lose its potential to serve departments and agencies.

the Year 2000 threat. Systems that support major programs and essential services may fail, and continuous delivery of these programs and services could be at risk.

12.158 In our view, there is a need for urgent and aggressive action on the part of the government, including engaging ministers and possibly parliamentary committees to champion Year 2000 projects. We also emphasize the need for substantive contingency planning to serve as a safeguard, particularly for major programs and essential services.

Treasury Board Secretariat's response:
The government has accorded the
Year 2000 issue the highest priority. An
aggressive action plan of governmentwide initiatives has been approved by the
Treasury Board. The government is
addressing common horizontal needs,
including human resource and
procurement issues to recruit and retain
sufficient skilled personnel to undertake
the required work. It is sharing best
practices and methodologies to ensure
maximum benefit from the work under

way. It is also monitoring and reporting departmental progress on an ongoing basis to ensure that appropriate actions are being taken as required. The pace of government activities is accelerating and will continue to accelerate in addressing this unique challenge.

With these actions the Treasury Board Secretariat is currently examining the state of readiness of all systems that support government services that the government deems 'mission-critical' to confirm that they will continue to function properly after 31 December 1999. Several steps are being taken by the Chief Information Officer Branch to understand and monitor departmental action plans for mission-critical systems, including the requirement that departments develop and submit contingency plans should such systems not be fully functional at that date.

The government generally agrees with the report's recommendations and acknowledges the Auditor General's contribution to greater awareness of this project.



About the Audit

Objective and Scope

The audit examined the risks and exposures that government programs and services face as a result of the Year 2000 threat. We reviewed the progress of Year 2000 projects at several departments to assess the government's general state of preparedness.

The audit serves to inform Parliament of the Year 2000 crisis and our assessment of the government's readiness in this regard and to prompt appropriate action on addressing critical systems and those that concern the interests of the Crown and the public. The audit also sought to identify and highlight issues and areas that require further attention from the government and Parliament in facing the Year 2000 challenge.

Nine departments were selected for examination — Agriculture and Agri-Food Canada, Correctional Service Canada, Department of National Defence, Health Canada, Human Resources Development Canada, Justice Canada, Public Works and Government Services Canada, Revenue Canada and Veterans Affairs Canada. The departments were selected because they deliver major programs and essential services to the public. Collectively, they also represent 32 percent of the government's budgetary expenditures and 94 percent of budgetary revenues forecast for 1996–97.

In order to gain a broader perspective on the state of preparedness across government, we also conducted a general survey of over 60 departments and agencies. They represent government organizations that are led by deputy ministers or those of an equivalent rank. The survey requested information and status as of 30 April 1997. About 50 responses were received; some did not address all the survey questions. We did not validate the responses provided by the participants.

We also examined initiatives undertaken by the Chief Information Officer Branch of the Treasury Board Secretariat to help mitigate Year 2000 risks to the government.

Criteria

Where appropriate, detailed criteria are discussed in sections corresponding to the observations and findings. The general criteria used in the audit are as follows:

- Leadership initiatives should be in place on a government-wide basis to address the challenge posed by the two-digit year coding practice in information technology as the year 2000 approaches, and to oversee progress in assessing and overcoming the challenge.
- At the departmental or agency level, there should be an organized plan and structure to secure senior
 management awareness and support, and to manage and contain risks in relation to the Year 2000 issue,
 including identifying and assessing risks and implementing and testing corrective action taken on
 systems, devices or facilities that may be affected.
- Initiatives should be in place to co-ordinate and facilitate Year 2000 efforts of departments and agencies to maximize their cost effectiveness.
- Management practices in addressing the Year 2000 issue should demonstrate due regard to economy and efficiency.

Information Technology: Preparedness for Year 2000

• Parliament should be kept informed of matters of significance arising from the Year 2000 challenge and its effects on government programs and service delivery.

Audit Team

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For information, please contact Nancy Cheng, the responsible auditor.

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Report of the Auditor General of Canada to the House of Commons

Chapter 13
Health Canada – First Nations Health

October 1997



Report of the Auditor General of Canada to the House of Commons

Chapter 13
Health Canada – First Nations Health

This October 1997 Report comprises 11 chapters and a Foreword and Main Points. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

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Chapter 13

Health Canada – First Nations Health

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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Health Canada - First Nations Health

Assistant Auditor General: Maria Barrados Responsible Auditor: Ronnie Campbell

Main Points

- 13.1 First Nations health is significantly worse than that of the general Canadian population. The health status of the First Nations population is affected by poor socio-economic conditions, which present considerable challenges to Health Canada and others who deliver health services to First Nations.
- 13.2 The management of community health programs through separate contribution agreements needs improvement. Health Canada does not monitor contribution agreements effectively. Clear and detailed descriptions of the programs to be undertaken in specific communities were often not available. In about two thirds of the agreements we examined, the Department did not have the required information on the activities carried out in the communities.
- 13.3 A sound framework for the transfer of health programs to community control has been developed and has allowed First Nations to start managing their own health programs. However, this framework has not yet been fully implemented. Required reports seldom provide performance information related to health, and requirements for program audits were not adequately met. In addition, the evaluation of the transfer initiative did not include any measures of changes to health.
- 13.4 Significant weaknesses exist in the management of pharmacy benefits under the Non-Insured Health Benefits program, allowing clients to access extremely high levels of prescription drugs. Although the Department has been aware of the problem of prescription drug misuse for almost 10 years, we found no evidence that the ease of access to prescription drugs has changed in any significant way. Despite the seriousness of the problem and numerous reports of prescription drug addiction and prescription-drug-related deaths in First Nations communities, action to intervene has been slow.
- 13.5 In an attempt to address program weaknesses, Health Canada is currently testing a point-of-service system that is to be fully implemented in the fall of 1997. Such a system has the potential to be a key mechanism in the control of drug use and the administration of pharmacy benefits. However, the Department needs to provide a clear protocol to guide intervention and will need to closely monitor pharmacists' overrides of warning messages.
- 13.6 Dental care providers tend to provide services up to the established frequencies and limits rather than based on needs, resulting in overservicing of some First Nations clients. The Department has piloted a predetermination process and plans to implement this needs-based model for the dental benefit nationally.
- 13.7 The Department has successfully implemented some cost management initiatives, resulting in a reduction in the rate of increase in direct program costs for non-insured health benefits from 22.9 percent in 1990–91 to 5.6 percent in 1995–96. However, further savings can be achieved in other areas, including dispensing fees and medical transportation. In addition, management needs to strengthen verification of claims and audits of providers.



Introduction

13.8 Health is an important concern for all Canadians. Overall, the health of Canadians compares favourably with that of people in other countries. However, disparities exist within the Canadian population. In particular, the First Nations experience significantly poorer health than the overall Canadian population.

13.9 A multitude of factors influence the health of a population, including the First Nations. The availability of high-quality health care is one important factor in determining health status. Many players are involved in the delivery of a variety of health services and programs.

First Nations health is significantly worse than the general Canadian population's

13.10 As of March 1997, First Nations comprised approximately 640,000 status (or registered) Indians and Inuit as defined for the purposes of the *Indian Act*. This represents about 2 percent of the Canadian population. Approximately 60 percent of First Nations members live on-reserve and 40 percent live off-reserve.

There are glaring differences in 13.11 health status between the First Nations population and the Canadian population overall (Exhibit 13.1). The 1996 Report of the Royal Commission on Aboriginal Peoples refers to the health status of Aboriginal people as both a tragedy and a crisis. The National Forum on Health recently concluded that the health of Aboriginal people continues to be significantly at risk. Some of the gaps identified have narrowed over the past several decades; however, significant disparities remain. For example, the First Nations infant mortality rate dropped from 2.5 times the overall Canadian rate in 1979 to 1.7 times in 1987 and has remained at that level since then.

Delivery of health services to First Nations presents considerable challenges

13.12 In addition to trying to address the significant gaps in health status, those who deliver health services to First Nations face other challenges. The population being served is geographically dispersed, often located in isolated communities. There are over 600 First Nations, that is, collectivities of status Indians and Inuit, some of which are made up of several communities. Many communities are located a considerable distance from cities and do not have direct or easy access to physicians and provincial health services. For example, there are 121 isolated communities with no road access, and an additional 75 communities that have road access but are more than 90 kilometers from the nearest physician. Further, many of the communities are small; about 75 percent have fewer than 1.000 members.

13.13 The health status of the First Nations population is affected by socio-economic conditions that, in many cases, are very poor. Exhibit 13.2 displays

There are glaring differences in health status between the First Nations population and the Canadian population overall.

- Infant mortality 1.7 times higher
- Life expectancy 7 to 8 years lower
- Rate of diabetes 3 times higher
- Rate of tuberculosis 6.6 times higher
- Suicide rates for young people –
 5 to 8 times higher
- Significantly lower levels of education
- Inadequate housing conditions
- High unemployment
- Low incomes
- Welfare dependency

Exhibit 13.1

First Nations Health Status Indicators as of 1993

(compared with general Canadian population)

Source: Health Canada

Exhibit 13.2

Major Socio-economic Factors
Affecting First Nations Health

Sources: Health Canada, Royal Commission on Aboriginal Peoples, National Forum on Health The objective of Health Canada's Medical Services Branch is to assist status Indians, Inuit and residents of the Yukon to attain a level of health comparable with that of other Canadians living in similar locations.

some of the important factors affecting
First Nations health, according to Health
Canada, the Royal Commission on
Aboriginal Peoples, and the National
Forum on Health. Those who deliver
health services have no control over these
factors that nonetheless impact on their
ability to achieve desired results.

13.14 There are a number of governments involved in the delivery of health services to the First Nations population, including the provincial and territorial governments, the federal government through Health Canada, and the First Nations local governments. There is a lack of a common view on their respective roles and responsibilities.

13.15 The provincial and territorial governments are primarily responsible for the delivery of health care services to the residents of their jurisdictions, including the provision of hospital and physician services. Some provinces have included First Nations in programs beyond basic services while others have not. The provincial and territorial governments consider that the federal government should accept full responsibility for all health programming for First Nations living on and off-reserve.

13.16 The federal government views health care as primarily a provincial responsibility. It considers that all residents of a province are entitled to provincial health services, including First Nations. It maintains that the federal government's provision of health services to status Indians and Inuit is based on policy and not on treaty or other legal obligations.

13.17 Most First Nations generally consider that all necessary health services must be provided to them under Aboriginal and treaty rights and, as such, represent a fiduciary obligation owed by the Crown.

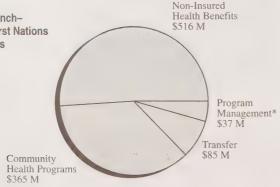
Medical Services Branch delivers health services to First Nations

It is in this environment that 13.18 Health Canada, through the Medical Services Branch, delivers health services to First Nations. The Branch, headed by an Assistant Deputy Minister, has a staff complement of approximately 1,800 full-time equivalents dedicated to this task. There are three key directorates at headquarters in Ottawa (First Nations and Inuit Health Programs; Program Policy, Transfer Secretariat and Planning; and Non-Insured Health Benefits) and eight regional offices (Atlantic, Quebec, Ontario, Manitoba, Saskatchewan, Alberta, Pacific and Yukon).

13.19 The objective of the Branch is to assist status Indians, Inuit and residents of the Yukon to attain a level of health comparable with that of other Canadians living in similar locations. The health services are provided through two programs: Non-Insured Health Benefits (NIHB); and community health programs. Expenditures for these services amounted to approximately \$1 billion in 1995–96 (Exhibit 13.3).

Exhibit 13.3

Medical Services Branch— Health Services to First Nations 1995–96 Expenditures



Total - \$1.0 billion

Source: Health Canada

Comprises those functions not associated with one specific program. 13.20 As a result of the 1994 federal Budget, program expenditures are required to be managed within a fixed financial envelope. Annual growth rates have been set at 6 percent in 1995–96, 3 percent in both 1996–97 and 1997–98, and approximately 1 percent in 1998–99. The Department has established regional envelopes, and there is flexibility for each region to move resources among programs within its allocation.

Community health programs are delivered in various ways

13.21 The community health programs consist mainly of programs and activities related to public health, health education and promotion, and strategies to address specific health problems such as alcohol and drug abuse. These are provided to First Nations individuals on-reserve. Exhibit 13.4 gives a brief description of

Exhibit 13.4

Community Health Programs

Program	Date Initiated	Description	Example of Activities
Nursing	1920s	Nurses are involved in a wide variety of roles, increasing with the isolation of the community. For reserves that are close to towns, the role of the nurse focusses on public health. For reserves that are isolated, nurses perform an expanded role, which also includes a certain amount of diagnosis and treatment of health problems and dealing with emergencies.	 Provision of prenatal care Visit to newborn babies and mothers Immunization Conduct of screening tests for children to identify problems early Provision of health information in school on dental care, nutrition, lifestyle, etc. Emergency treatment (in isolated communities)
Community Health Representatives (CHR)	1960s	The CHRs are usually members of First Nations communities who often work with and assist the nurse in the community health activities. Their role has evolved over time and varies from one community to another.	
National Native Alcohol and Drug Abuse Program (NNADAP)	1982	The objective is to arrest and offset high levels of alcohol and drug abuse in First Nations and Inuit communities. This is done mostly through treatment in NNADAP facilities and through prevention at the community level.	 Various workshops Organizing gatherings and other events Individual and group counselling Education sessions in schools
Brighter Futures	1992	The goal of the Indian and Inuit component is to encourage and support the well-being of children, individuals and families. The program is organized into six components: mental health; child development; solvent abuse; injury prevention; healthy babies; and parenting skills.	Early identification of abusers Referral to treatment Aftercare and support following treatment
Building Healthy Communities	1994	The goal is to address needs not met by other programs. It includes three components: mental health; solvent abuse; and home nursing.	

five of the key programs: Nursing, Community Health Representatives, National Native Alcohol and Drug Abuse Program, Brighter Futures (also called Child Development Initiative) and Building Healthy Communities.

The delivery mechanisms for 13.22 community health programs have changed over time. Initially these programs were delivered directly by Medical Services Branch. Now they are delivered mostly through arrangements with First Nations organizations. The Branch uses three basic types of agreements that give First Nations varying degrees of flexibility, control and responsibility to design programs. In increasing order of flexibility, these are separate contribution agreements, Integrated Community-Based Health Services agreements and transfer agreements (see Exhibit 13.5 for details).

13.23 The ultimate objective is to improve the health of First Nations

through good programs and services at the community level. The type of arrangement chosen is not the end — it is only the means to achieve the end.

Departmental data show that, as of 31 March 1997, approximately 27 percent of First Nations had signed a transfer agreement and 13 percent an integrated agreement. The remaining 60 percent were delivering programs under separate contribution agreements. Expenditures on community health programs and transfer agreements amounted to \$450 million in 1995–96 (see Exhibit 13.6 for a breakdown).

13.24 In March 1994, Health Canada directed Medical Services Branch to continue the devolution of its Indian health resources to First Nations control within a time frame to be determined in consultation with First Nations and Inuit communities, and to move out of health care service delivery. The Branch projects

Exhibit 13.5

Characteristics of Arrangements for the Delivery of Programs

	Separate Contribution Agreement	Integrated Community- Based Health Services Agreement	Transfer Agreement
Flexibility allowed First Nations to design programs	Minimum	Medium	Maximum
Flexibility to First Nations to reallocate resources across programs	None	Medium	Maximum
Annual reporting requirements	Separate activity reports for each program Separate financial reports for each program	 One activity report for all programs Separate financial reports for each program 	Annual report including mandatory programs Comprehensive financial and program audit
Provision of funds for management	None (with some exceptions)	Medium (half that under transfer)	Maximum
Detailed monitoring by the Department	Maximum	Medium	Minimum
Accountability of First Nations to community members	Medium	Medium	Maximum
Accountability of First Nations to the Minister and of the Minister to Parliament	Same	Same	Same

that approximately 60 percent of First Nations will be under transfer agreements by 1999–2000.

13.25 The Branch's delivery of community health programs is decentralized. Responsibility for the delivery of the programs rests mainly with the regional directors. The vast majority of staff involved in community health programs and the transfer process are in the regions.

A variety of non-insured health benefits are provided to First Nations people

13.26 Medical Services Branch pays for a number of health-related services such as pharmacy, dental and vision care that are provided to First Nations clients. In

1979, the federal government introduced an Indian Health Policy that established a framework for the delivery of all Indian and Inuit health programs. The goal of the policy is to achieve an increasing level of health in Indian communities, generated and maintained by the communities themselves. The program principles were subsequently established, specifying that benefits are to be provided according to medical or dental need or a comparable Canadian standard, and that the NIHB program is the payer of last resort.

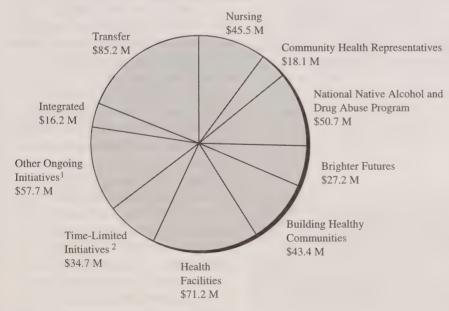
13.27 The objective of the program, as indicated in a renewed policy mandate proposed by the Department in April 1997, is described in Exhibit 13.7. The program is not recognized in any

The Non-Insured
Health Benefits
program is not
recognized in any
legislation, but is
provided by the federal
government as a
matter of policy.

Exhibit 13.6

1995–96 Expenditures on Community Health Programs and Transfer

TOTAL: \$449.9 million



Notes:

- ¹ This includes hospital, nutrition, environmental health, community clerks, some management functions not specific to any one program and others.
- ² This includes Canada Drug Strategy, Tobacco Demand Reduction Strategy, National Aids Strategy, Family Violence and others.

legislation, but is provided by the federal government as a matter of policy. Parliament is asked each year through appropriation acts for the authority and resources to provide these services. Exhibit 13.8 shows 1995–96 NIHB expenditures by benefit category.

13.28 While the Non-Insured Health Benefits program is not subject to transfer at this time, some pilot projects aimed at examining future management options have been considered. Planning is under way with a view to obtaining appropriate authority to transfer the program to First Nations control.

Focus of the audit

13.29 We examined the way the Medical Services Branch manages health programs delivered to First Nations. The audit focussed on community health programs delivered through separate contribution agreements; the transfer of health programs to community control; and non-insured health benefits. Our examination included a follow-up of our previous audit of NIHB, reported in Chapter 19 of the 1993 Report. Further details on the audit scope, objectives and criteria are presented at the end of the chapter in About the Audit.

Exhibit 13.7

Non-Insured Health Benefits Program Objective The purpose of the program is to provide non-insured health benefits to First Nations and Inuit people in a manner that:

- is appropriate to their unique health needs;
- contributes to the achievement of an overall health status for First Nations and Inuit people that is comparable with that of the Canadian population as a whole;
- is sustainable from a fiscal and benefit management perspective; and
- facilitates First Nations/Inuit control at a time and pace of their choosing.

Observations and Recommendations

Community Health Programs Delivered through Separate Contribution Agreements

Balancing the need for flexibility with fulfilment of obligations is a challenge

Medical Services Branch expects that communities with separate contribution agreements will implement activities that more closely follow the programs designed by the Branch. First Nations have some flexibility to tailor the programs to meet their needs, but within the program framework developed for each program. The Minister remains responsible and accountable to Parliament for the funds spent and the results achieved. The Department's challenge is to allow and encourage First Nations to tailor programs to meet their needs and, at the same time, fulfil its own obligations to manage programs efficiently and effectively.

13.31 The expectation is that officials will work more closely with First Nations under separate contribution agreements than with those who have transfer agreements. We expected that Medical Services Branch would know how a First Nation intends to spend program money and what it expects to achieve, would gather and review community reports on what has been accomplished, and would work constructively with the First Nation to help build capacity and improve programs and services.

13.32 We observed that although these elements are indeed reflected in the structure of most of the arrangements, the relationship in practice is quite different.

Overlapping of programs makes them difficult to administer

13.33 We found that many of the community health programs overlap and are trying to address the same problems. For example, both Brighter Futures and Building Healthy Communities include activities to improve the mental health and well-being of the community and are expected to reduce the high level of suicides. Solvent abuse is to be addressed specifically by parts of these two programs as well as the National Native Alcohol and Drug Abuse Program (see Exhibit 13.9).

13.34 The Department recognizes the need to manage the programs so that they complement each other. Branch officials in the regions have encouraged First Nations to consider related programs together, so that the various activities are co-ordinated in the community. In one region, the funds available from two programs were merged together in the agreements and Branch officials were prorating the reported expenditures. Nonetheless, these programs are delivered and accounted for separately. The overlap makes it confusing and difficult for both First Nations and Medical Services Branch to administer them as separate programs.

13.35 The Department is accountable for the programs it delivers, whether directly or indirectly through arrangements with third parties; it has to report to Parliament every year on program performance. Overlaps in programs increase the difficulty of attributing results to a specific program.

13.36 The Department should review its program structure and ensure that it reflects the manner in which the programs are actually delivered.

Department's response: Agreed. This recommendation will be discussed with Treasury Board officials.

Specific expectations and activities under agreements are often not clearly stated

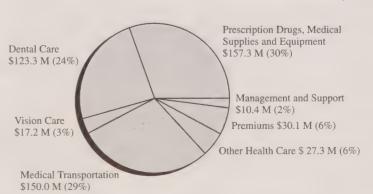
13.37 The community health programs are designed to allow First Nations to tailor them to meet the needs of their communities. We expected that each First Nation would clearly define at the beginning of each year what it intends to do and achieve. This could be included in the agreement or provided in a separate workplan.

13.38 We found clear and detailed descriptions of the programs to be undertaken in specific communities in approximately 60 percent of cases for Brighter Futures and Building Healthy Communities and in less than 20 percent of cases for National Native Alcohol and Drug Abuse Program and Community Health Representatives (see Exhibit 13.10). In the latter cases, the only description available was often a generic one used for all communities in a given

Many of the community health programs overlap and are trying to address the same problems.

Exhibit 13.8

Non-Insured Health Benefits 1995–96 Expenditures



Total - \$515.6 million

The Department had none of the required information on the activities carried out under two thirds of the contribution agreements.

zone; it did not specify what a particular community was going to undertake. In about a third of the cases, for all programs, there were no clear descriptions of objectives and activities.

13.39 When we did find a specific program description, it usually included some health-related objectives and a list of activities to be conducted. About 80 percent of the cases gave no indication of how the community would know whether the activities were successful. Indicators such as participation rates for workshops or number of visits to elders were not specified.

13.40 The Department should ensure that the contribution agreements are clear about specific objectives and activities that the First Nation will undertake. It should encourage First Nations to define measures of success.

Department's response: Agreed.

Activity reports are not provided consistently

13.41 The contribution agreements usually require that activity reports be produced at the end of the year or periodically throughout the year. The

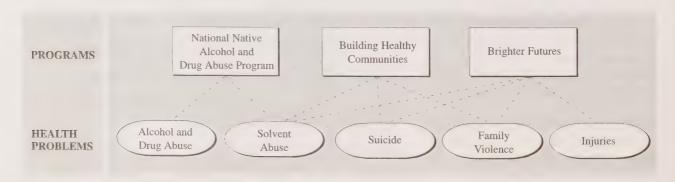
activity reports can be valuable tools for the First Nation to review and improve programs, and for Medical Services Branch to ensure that the programs are managed efficiently and effectively.

13.42 For about 67 percent of the agreements we examined, the Department did not have the required activity reports (see Exhibit 13.10). In other words, the Department had none of the required information on the activities carried out under two thirds of the agreements. Departmental officials told us that they obtain knowledge of community activities more informally, through their periodic contacts with the health workers and visits to the communities.

13.43 We found that when activity reports had been produced they were mainly lists of activities. Some included information on services provided, such as the number of people visited or counselled and the rates of participation in activities. A small number also noted positive effects of the activity, such as the creation of a support group, and assessments that could be used to improve the activity in the future, such as providing for day care when information sessions are targeted to parents. This type of assessment needs to be encouraged.

Exhibit 13.9

Overlapping between Some Programs and Health Problems



13.44 The Department should ensure that it receives the activity reports required under contribution agreements. It should work with First Nations to improve these activity reports so that they provide information on results achieved.

Department's response: Agreed.

Management of contribution agreements needs improvement

13.45 We expected that the Branch would monitor contribution agreements to get the information it needs to fulfil its obligations and to help First Nations build capacity and improve management practices in their communities. This would provide the basis for First Nations to improve the programs and prepare to take on additional responsibilities under transfer agreements.

13.46 However, we found that Medical Services Branch does not monitor contribution agreements effectively. As we have already noted, a clear description up front of what is to be done and achieved and a report on performance at the end of the year were often not available. The Branch rarely took steps to clarify descriptions and obtain the required activity reports. Often, even when it has received these documents it has not reviewed them with a view to improving them in the future and improving the health services provided. Departmental officials mentioned that they visit communities and discuss issues with community workers, which allows them to know and influence what is being done. It is interesting to note that the good program descriptions and activity reports we saw were from the regions or zones where the Branch has asked for the required reports, thus reinforcing their importance, and where it has helped to

produce them by providing a predeveloped reporting form.

13.47 The level of responsibility undertaken by a community is supposed to depend, in part, on the extent to which it has demonstrated its ability to manage that responsibility. However, the Branch has not taken the opportunity to build capacity by ensuring that management practices are in place in the communities to deliver these important programs.

13.48 Departmental officials are aware of cases where the provision of good-quality health services in the communities is hampered by inadequate management:

- In some cases, there is little or no supervision of band employees.
- In some cases, community workers delivering related services are working in isolation from each other.
- In some communities there are indications that the expected services are not being provided, given that some band-employed health workers are not working the required number of hours or are on extended leave and have not been replaced.

The Branch has not taken the opportunity to build capacity by ensuring that management practices are in place in the communities to deliver these important community health programs.

Exhibit 13.10

Assessment of Contribution Agreements

Program (A) (B) (A)	Agreements with clear objectives and activities for the specific community	Agreements with activity reports
Community Health Representatives	15%	39%
National Native Alcohol and Drug Abuse Program	19%	32%
Brighter Futures	59%	32%
Building Healthy Communities	59%	27%
For all programs	38%	33%

Note: Based on an analysis of contribution agreements from 40 communities.

We found the framework for the transfer of health programs to community control to be basically sound.

- In some cases, the competency or qualifications of some community workers have been questioned.
- 13.49 No clear action has been taken to solve these problems and to make sure that sufficient results are achieved with the funds provided. Other studies and reviews have reported similar concerns:
- The 1989 evaluation of projects in the National Native Alcohol and Drug Abuse Program noted that the majority of workers said they were not supervised and there were few prevention activities conducted at the community level, such as education sessions in school.
- A 1993 review of the Community Health Representatives Scope of Practice noted the lack of adequate training or of adequate numbers of trained personnel.
- 13.50 In summary, we found that the management of separate contribution agreements was weak. In the majority of cases, Branch officials did not insist that sound management practices be in place and that the required reports be produced. There was very little follow-up with First Nations to build capacity.

Transfer of Health Programs to Community Control

A sound transfer framework has been developed

13.51 The Department's objective in transferring health programs to First Nations control has always been to improve the health status of Indian people by allowing First Nations to assess their own needs and design programs to meet them. Under transfer agreements, the First Nations are no longer bound by the programs designed by Medical Services Branch and can sign agreements for up to a five-year period. Only the resources spent by the Branch on community health programs, and not those spent by

provinces or other departments, can be included in the transfer agreements.

Department encourages greater accountability by First Nations toward their communities, recognizing at the same time that the Minister of Health retains accountability for the use of public funds and for overall results. In order to meet the transfer objectives and also fulfil these accountability obligations, the Department in 1989 developed a transfer framework for specific agreements (see Exhibit 13.11). In addition, an evaluation of the transfer initiative was conducted jointly in 1995 by the Department and the First Nations involved.

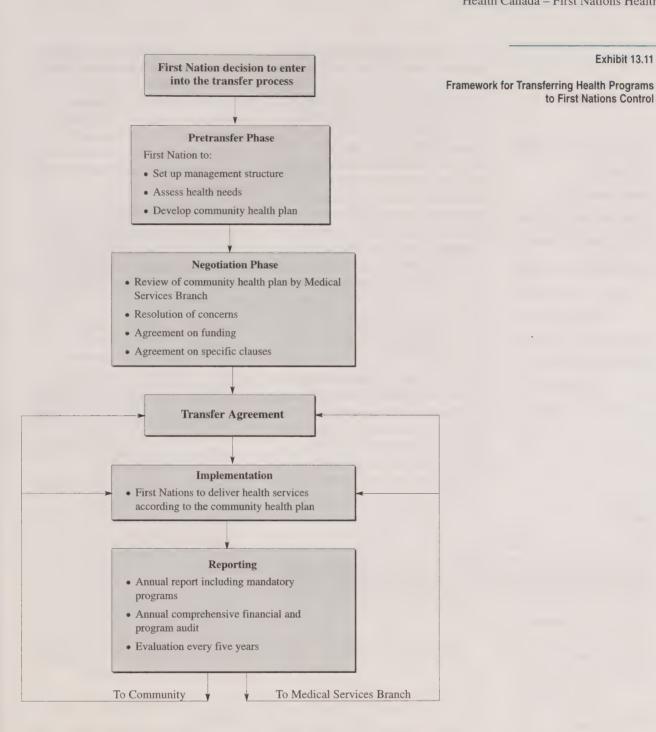
13.53 We reviewed the transfer framework and found it to be basically sound. However, the take-up for transfer has been slow. In Alberta, for example, only one First Nation had signed a transfer agreement at the time of our audit. The evaluation of transfer noted that certain concerns of First Nations have presented real barriers to negotiating transfer agreements. These include concerns about the recognition of treaty rights and questions about the future roles and responsibilities of Health Canada.

Transfer has allowed First Nations to start managing their own health programs

13.54 During the pretransfer phase, First Nations developed their community health plans and defined the roles and responsibilities of the various staff, including the health director. Medical Services Branch considers that the community health plan is the key to a successful transfer, and it has defined a series of elements required in these plans. The majority of the plans we reviewed included many key elements (see Exhibit 13.12 for details).

Exhibit 13.11

to First Nations Control



13.55 More clarity is required in describing what the programs are intended to achieve. Consistent with the requirement of the transfer framework developed by Medical Services Branch, we expected that the community health plans would define the objectives of the

programs and would indicate the health status data and results measures to be collected. We found that most plans defined broad objectives and included a corresponding list of activities. However, many did not clearly specify what was to be achieved, or how this was to be

Many regional officials stressed the importance of a transition period after the transfer agreement is signed.

measured. This is an area that needs to be continually developed and improved.

13.56 During the negotiation phase, Medical Services Branch reviewed the majority of community health plans and discussed with First Nations various matters that were not covered in the plans. In that way, it encouraged First Nations to establish good practices. The transfer agreements stipulate that the health services are to be guided by the community health plan. We therefore expected that once the concerns had been resolved, adjustments would be reflected in the community health plans. However, we found that the community health plans were rarely updated to reflect the negotiated adjustments.

13.57 The transfer framework makes it clear that the community health plan, as a key planning document, should be updated regularly to keep it current. We expected that when renegotiating an agreement, usually after five years, Medical Services Branch officials would

Exhibit 13.12

Assessment of Community Health Plans

Selected elements required in the plan by the transfer framework	Plans that included the element	
Identification and prioritization of the needs of the community	92%	
Description of the programs to be undertaken	88%	
Description of the role of the Medical Officer of Health	83%	
Identification of the Medical Officer of Health	50%	
Description of how the professional staff will be supervised	79%	
Identification of the requirement for nurses to be registered in the province	67%	

Note: Based on an analysis of community health plans for 24 of the 68 transfer agreements signed at the time of the audit.

request and review the most recent update of the plan and use it as the basis of the renewed agreement. We observed that about three quarters of the renewed transfer agreements were based not on updated plans but on the community health plans developed at the beginning of the transfer process, more than five years earlier.

13.58 The Department should ensure that updated community health plans that meet the basic requirements are prepared, and that they form the basis of both initial and renewed transfer agreements.

Department's response: Agreed.

A transition period is important

Many regional officials stressed the importance of a transition period after the transfer agreement is signed, to allow the communities to learn about the programs. They mentioned that they need to spend a lot of time with the communities during that period because the communities often encounter difficulties or unforeseen challenges and seek help and advice from Medical Services Branch. Some departmental officials are concerned that as the Department's role changes, they may not be able to continue with the necessary capacity building. We believe that interaction between the First Nations and the Branch during the transition period is important and needs to continue.

Performance reporting needs to focus on results

13.60 The transfer framework recognizes the accountability of the Chiefs and Councils to their members and to the Minister, as well as the Minister's accountability to Parliament. The reporting requirements are designed to support all of these accountability

relationships (see Exhibit 13.11). Therefore, the reports need to be useful to both the First Nations and the Medical Services Branch.

13.61 We believe it is important for managing and for accountability that the results of programs be measured to the extent possible and reported in sufficient detail. We expected that achievements would be reported in terms of services provided (such as immunization rates. attendance at particular workshops and events or number of clients counselled) and in terms of desired changes to health (such as reductions in the incidences of diseases, injuries, suicides or alcohol abuse). Both aspects are important, because some activities may appear to be successful without producing the desired change in health. For example, diabetes is a known problem in many communities; some First Nations are trying to prevent and control diabetes by providing information on the importance of factors such as nutrition and fitness. Such activities might be judged successful based on the number of people reached by the information. However, if this does not contribute to a reduction in the number of people with diabetes or an increase in the number of people controlling their diabetes, then the activities may need to be refocussed. More individual counselling, or more participatory activities such as walking clubs, might be considered.

13.62 The transfer agreements require First Nations to prepare an annual report to their communities summarizing the programs undertaken and providing data on services and their results. We found that most First Nations have prepared the required reports. Our examination of these reports showed that information on what has been done is given in terms of a description of the programs and,

sometimes, measures of the services provided. However, the reports seldom include performance information related to health — that is, whether the desired changes to health are taking place.

13.63 The transfer framework requires that an evaluation of effectiveness be conducted by the First Nation every five years, and funds are provided for that purpose. Only four of the 24 agreements we reviewed had been in place for more than five years; two of those had not been evaluated. Three other First Nations conducted an evaluation much earlier than the end of the five-year period.

The transfer framework also 13.64 requires these evaluations to assess whether the programs have achieved their objectives and produced the intended effects. We found that evaluations that have been undertaken have rarely measured the changes to health resulting from the programs. They typically reviewed the operations and the management of health programs. For example, some evaluations noted that the prevention and promotion activities were not conducted to the extent planned. This is useful information that can serve to improve operations. However, it does not satisfy the requirements of the transfer framework. We recognize that this is not easy. But there is a need to start working in that direction to see some practical progress in the short term and further progress over time.

13.65 The Department should work with First Nations to improve measurement of the services provided and of expected changes to health. These measures should be included in the annual reports. In addition, the Department should ensure that First Nations conduct the required evaluations of the achievement of program objectives.

Most First Nations
have prepared the
required annual
reports. However, the
reports seldom include
performance
information related to
health.

Department's response: Agreed. It is important that a balance be achieved between reporting mechanisms designed so that First Nations program managers can be accountable to community membership while ensuring that information necessary for departmental accountability is provided. Work is currently under way to develop a new Accountability Framework for the Program, which will be appropriate for the increased control by First Nations through transfer and self-government. Associated performance and outcome measures will have a results orientation. This work will be done in conjunction with First Nations. It is expected that the work will be completed during the 1998-99 fiscal year and that it will be reflected in agreements signed after that.

The audit requirements were not adequately met

- 13.66 Under transfer, responsibility for the design and delivery of the programs rests with the First Nation. The transfer agreements require an annual comprehensive financial and program audit, with opinions on:
 - fairness of the financial statements;
- adequacy of financial controls in place;
- compliance with the terms and conditions of the agreement; and
 - provision of mandatory programs.
- 13.67 Such a comprehensive audit would inform Health Canada of the extent to which all conditions have been met, financial and non-financial. More specifically, it would allow the Department to assess performance with respect to mandatory program requirements.
- **13.68** For most First Nations, we found that an auditor's report concluding on the fairness of the financial statements was

available; about half included all the financial operations of the First Nations and half were related specifically to health programs. However, only one of the agreements we examined had an audit opinion covering the other required aspects: adequacy of financial controls, compliance with the terms and conditions of the agreement, and provision of mandatory programs.

- 13.69 Some departmental officials told us that they were not clear on what the comprehensive audit is supposed to examine and what type of audit opinions are expected.
- 13.70 The Department should clarify the nature and scope of the audit requirements under transfer agreements and ensure that the required audit opinions are provided.

Department's response: Agreed. The Program will work with the Internal Audit Directorate of the Department to ensure that the audit requirements reflect the new accountability framework, emphasizing First Nations control, and that these are well understood by departmental officials and transferred communities.

The evaluation of the transfer initiative did not measure changes to health

- 13.71 In addition to the reporting required under specific transfer agreements, in 1995 the Department and First Nations conducted a joint evaluation of the transfer initiative. We found significant deficiencies in this evaluation.
- 13.72 Although it was expected to assess the impact of transfer on the health of First Nations, it did not include any measures of changes to health. We believe that such measurement, while difficult, is possible and should have been conducted. Without this information, it is not possible to determine whether transferring programs to First Nations control will in

fact contribute to improved health, as is generally believed.

13.73 One of the difficulties is the absence of indicators of health that could be used in such an evaluation. One departmental official advised us that the joint evaluation committee will meet again in 1997 to determine how to measure changes to the health of First Nations after transfer, and that these measures will be used in the next evaluation.

13.74 The Department should ensure that future evaluations will determine the extent to which the transfer initiative contributes to improving the health of First Nations.

Department's response: Agreed. The development of measures to determine the impact of any one program or activity on health status has proved difficult for all health systems. Recent improvements in both methodology and technology will assist the Department to work with First Nations to produce useful and meaningful measurements.

13.75 In summary, we observed that the management of the transfer process has had some strengths; it has allowed First Nations to put in place management practices for their own health programs. However, some key reports have not been produced as required under transfer agreements and, in many cases, reports have not included the required information on performance.

Non-Insured Health Benefits

13.76 The NIHB program provides a range of health benefits and services that supplement provincial and third-party health insurance programs. As of March 1997, these benefits included prescription drugs, medical supplies and equipment, dental care, vision care, medical

transportation, other health care services (such as physiotherapy and chiropractic care) and, in Alberta and British Columbia, medical insurance premiums. Benefits are provided to First Nations people living on and off-reserve. Direct program benefit costs increased substantially from \$307 million in 1990–91 to approximately \$505 million in 1995–96.

Risks associated with the program

- 13.77 The program provides benefits that are free, including prescription drugs, which can be misused or abused. Also, the program entails the processing of a large number of claims. Given these factors, the risks associated with the program include the following:
- some doctors may overprescribe medications to patients, using program resources;
- the costs of the program may escalate to an unsustainable level;
- some clients may access excessive levels of benefits;
- some clients may abuse or misuse prescription drugs;
- some dentists may overservice clients; and
- some providers may overbill for services provided to clients.
- 13.78 We would expect management to assess these risks, put in place appropriate controls, closely monitor the program and take timely corrective action when problems are identified.

Departmental concerns about physicians' prescribing practices

13.79 Most of the above are risks that the Department has the ability to address directly. However, this is not the case with physicians' prescribing practices. The Department is concerned that some

Savings have been realized in some areas but more needs to be done.

Significant weaknesses exist in the management of pharmacy benefits.

doctors may be overprescribing mood-altering or central nervous system drugs to First Nations patients. The Department's own analyses indicate that some doctors are issuing very large numbers of prescriptions to NIHB clients.

13.80 The Department does not control or regulate the prescribing practices of doctors. However, departmental officials have raised the issue by communicating directly with some doctors. In some of those cases, departmental data show a subsequent reduction in prescriptions by the doctors. However, management is concerned that these changes may be temporary, and is frustrated by the limited success of this approach.

Cost savings are being realized

13.81 Direct program benefit costs rose more than 64 percent between 1990–91 and 1995–96. This was true for each of the major categories of benefit — pharmacy, dental care and medical transportation. Efforts to contain these increases have been under way since 1994.

13.82 While direct program benefit costs rose by more than 64 percent from 1990–91 to 1995–96, the annual increase was in fact down from 22.9 percent in 1990–91 to 5.6 percent in 1995–96. This was largely due to a number of ongoing departmental cost management initiatives, including a revised dental schedule and improved management of mental health counselling. In 1996–97, the Department

As of 31 March 1997:

Prescription Drug Dispensing Fees

Exhibit 13.13

- **Note**: Fees quoted represent maximum amounts charged per transaction.
- Health Canada paid \$8.85 in dispensing fees compared with \$6.47 paid by another federal agency and \$6.11 by the provincial government drug plan in Ontario.
- In Newfoundland, Health Canada paid \$7.90 in dispensing fees while pharmacies charged the provincial government drug plan for welfare recipients a mere \$3.92.

was also successful in negotiating reduced premium costs in Alberta. Management has predicted a 3.2 percent decrease in direct program costs in 1996–97.

- 13.83 Savings have been realized in some areas but more needs to be done. The potential for savings exists in many other areas.
- 13.84 For example, a 1995 study by the Department estimated potential savings of \$5.7 million if dispensing fees paid by Health Canada for prescription and over-the-counter drugs were more in line with private sector plans. In most provinces, Health Canada pays a dispensing fee for over-the-counter drugs such as aspirin because NIHB clients require a prescription to obtain these drugs. In 1995–96, dispensing fees for over-the-counter drugs amounted to \$9.9 million, representing 44 percent of the total expenditures for these drugs.
- 13.85 Progress has been slow in negotiating dispensing fees with provincial pharmacy associations in some regions. As of March 1997, Health Canada continued to pay higher dispensing fees for prescription drugs than other plans in most provinces (see examples in Exhibit 13.13).
- 13.86 As described in other parts of this chapter, improvements in monitoring the use of prescription drugs and medical transportation, audits of providers, and a system for predetermining dental benefits also have the potential to achieve savings. Given that funds are allocated by regional envelopes, savings realized in various areas represent an opportunity to redirect funds into other areas where they are needed most.

Significant weaknesses exist in the management of pharmacy benefits

13.87 Prescription drugs, over-the-counter drugs and medical

supplies and equipment represent the largest NIHB benefit, with total expenditures of about \$157 million in 1995–96.

13.88 Program directives and guidelines specify that prescription drug benefits are available free to First Nations members if the item is not available to the client under other health plans and is considered medically necessary, that is, prescribed by a qualified physician or dentist. Over-the-counter drugs also require a prescription to be eligible under the program. The Department does not require a co-payment or deductible for the benefit.

13.89 As described in Exhibit 13.14, NIHB clients are required to obtain a prescription from a physician or, in some cases, a dentist in order to obtain free prescription drugs and over-the-counter drugs. Physicians have to rely on the NIHB patient to disclose drug use and visits to other doctors when they prescribe the medications.

13.90 Pharmacy providers dispense prescription drugs based on either a

written or verbal prescription. Unless otherwise preauthorized, Medical Services Branch has established a three-month supply as the maximum quantity that can be dispensed at a time. Before a prescription is dispensed, the patient has to tell the pharmacist his or her name, date of birth and a client identification number. The client identification number can be an Indian registration number, a band number and family number, or a number issued by the Branch. However, the patient does not have to provide a complete address.

13.91 Currently, pharmacy providers are not connected to a system or network that provides information on the prescription drugs obtained by the NIHB client. They cannot tell whether the patient has gone to different doctors or visited other pharmacies to obtain prescription drugs. However, pharmacy networks do exist and are being used by several provinces to administer their drug benefit programs.

13.92 In 1987, the Department entered into a contract with a private sector firm to develop and operate a claims-processing system for dental

Exhibit 13.14

Overview of the Prescription Drug Process under Non-Insured Health Benefits – Roles and Responsibilities of Parties Involved

Prescribers (doctors/dentists)	First Nations individuals	Providers (pharmacists)	Contractor for Health Canada	Medical Services Branch
 prescribe medications to First Nations patients specify "no substitution" where appropriate request information on other prescriptions 	obtain a prescription for prescription drugs and over-the-counter drugs provide an acceptable client identification number to pharmacist	request information on client identification and other coverage dispense drugs based on written/verbal prescription submit claims to Health Canada contractor	 process and verify claims verify that services are received by NIHB clients pay providers and invoice MSB for services maintain audit control of providers 	responsible for managing the program ensure that contractor complies with contractual requirements provide funds to contractor for payment of provider claims and operations

Departmental data showed cases where individuals had accessed extremely high quantities of mood-altering drugs over short periods of time. accounts. Since April 1990, the
Department has had a second contract
under which the contractor has developed
and operated a similar automated system
to process claims for the pharmacy
component of the program. The
Department assures us that the system was
developed by the contractor to be
consistent with industry standards and
practices comparable with other drug
benefit plans.

Pharmacy providers submit their 13.93 claims (approximately 5.8 million transactions in 1996) directly to the contractor to be reimbursed for pharmacy benefits dispensed to NIHB clients. These claims contain details on the NIHB client, the identification of the prescriber, and the date and description of the drug dispensed. However, the claims are not accompanied by supporting documentation, such as copies of prescriptions. The contractor advises us that this is consistent with industry practice. Thus, the contractor is not able to review any supporting documentation before reimbursement to verify that there is a valid prescription or that the client has received the benefit.

13.94 Health Canada pays the contractor for services rendered and provides funds to cover anticipated claim payments to providers. It does not verify documentation supporting the claims before paying the contractor.

weaknesses. The claims filed do not include addresses of the individuals to whom services have been provided. The Department sees this as a hindrance to contacting the individuals directly to confirm that they have received the benefits. Pharmacists do not have access to information on patients' prescription drug use, the contractor does not receive and verify supporting documentation before paying providers, and the Branch

does not review supporting information before paying the contractor. Further, as described in a later section, the audit regime is weak.

13.96 In addition, no thresholds have been established at which management could intervene in a timely way and query claims that indicate potentially inappropriate drug use patterns. The Branch does maintain detailed information, but this is reviewed retrospectively and anomalies are identified after the fact.

13.97 These flaws have contributed to an environment where abuses of the prescription drug benefit occur, as the following section explains.

The program allows clients to access excessively high levels of prescription drugs

13.98 We reviewed departmental data and found that some First Nations individuals were receiving large amounts of prescription drugs. Management believes that misuse of prescription drugs has been occurring for some time.

13.99 Prescription drug abuse refers to the use of a drug in a manner that deviates from use generally accepted by the medical community as appropriate in the circumstances in which it is prescribed. It includes the inappropriate prescription of drugs by physicians, the misuse of prescribed drugs by the patient, and the practice of visiting different doctors to get prescriptions and "shopping" pharmacies to obtain prescription drugs.

13.100 The Department has been aware of the problem for almost 10 years. However, we found no evidence that the ease of access to prescription drugs has changed in any significant way. Departmental data showed cases where individuals had accessed extremely high

quantities of mood-altering drugs over short periods of time.

13.101 In fact, some of the amounts were so high that departmental reviews of individual drug use profiles raised serious questions about whether the individuals were actually taking the prescription drugs obtained or were using them for other purposes. This is because the amounts obtained were several times the recommended maximum dosage limits. In some cases, a medical officer noted that the patients concerned would likely be unconscious or non-functioning if the drugs were taken as prescribed. Yet these individuals continue to claim, and the Department continues to pay, for excessive amounts of prescription drugs.

13.102 We performed an analysis of departmental data on prescription drug use for a three-month period, analyzing not only the number of prescriptions that individuals received but also the numbers of different drugs received and doctors

and pharmacies visited. Because Health Canada had developed few criteria to monitor prescription drug use, we used criteria established by some provincial bodies.

13.103 The data for the three-month period showed that over 15,000 NIHB clients went to 3 or more pharmacies to obtain prescription drugs. Nearly 1,600 NIHB clients obtained more than 15 different prescription drugs and over 700 clients got 50 or more prescriptions. The results of our analysis are shown in Exhibit 13.15.

13.104 As mentioned earlier, information systems allow management to review data retrospectively. However, the system does not use thresholds indicating what levels of drug use are reasonable, what levels require further explanation, or what levels the Branch would consider to be excessive.

13.105 The Department acknowledges that a contributing factor is "doctor shopping" — individuals visit a number of

Region	Number of clients going to 3 or more pharmacies	Number of clients getting over 15 different drugs	Number of clients getting at least 50 prescriptions
Pacific	1,931	107	97
Alberta	5,354	867	387
Saskatchewan	2,960	199	22
Manitoba	1,991	129	37
Ontario	1,728	121	63
Quebec	373	39	84
Atlantic	678	137	20
Total	15,015	1,599	710

Exhibit 13.15

Analysis of Access to Prescription Drugs by Non-Insured Health Benefits Clients

First Quarter of 1996

Notes:

- 1. Total eligible clients at March 1996: approximately 620,000.
- 2. Number of drug claimants in all regions during period: approximately 257,000.
- The following criteria (for a 90-day period) are used by some provincial bodies to identify cases for review:
 - going to three or more pharmacies to get prescription drugs dispensed
 - obtaining more than 15 different prescription drugs
 - obtaining 50 or more prescriptions

The implications for First Nations health are significant. doctors, enabling them to obtain a large number of prescriptions. Departmental data showed that some individuals obtained similar prescriptions from several doctors within a short period of time. However, the field identifying the doctor, which can be a name or a number, is not subject to any edits and accepts anything that is input. Due to the existence of many anomalies, inconsistencies and errors, it was not possible to accurately determine the extent to which doctor shopping occurs.

Serious implications for First Nations health

13.106 Although prescription drug misuse is not unique to First Nations, the seriousness of the problem and the implications for First Nations health are significant, particularly when the program is intended to improve the health of First Nations.

13.107 Between 1986 and 1996, there were numerous reports of prescription drug addiction and prescription-drug-related deaths of First Nations individuals in several provinces. In Alberta, for example, the Medical Services Branch regional office identified a total of 42 prescription-drug-related deaths in First Nations communities during 1986–88. Subsequent media reports indicate that serious problems still exist. This includes one community of 500 people where 15 such deaths were reported to have occurred in four years.

13.108 We reviewed Branch data and found that the prescription drugs most frequently obtained by NIHB clients are central nervous system drugs, such as acetaminophen with codeine and benzodiazepines. A number of medical studies have found that excessive use of certain mood-altering drugs causes serious side effects and withdrawal reactions.

They include sedation, impaired memory, decreased cognitive agility, insomnia and visual disturbances. Although these studies are not specific to First Nations, they point to the consequences of excessive use of these drugs.

Action to intervene has been slow

13.109 Health Canada maintains that, while it is important to remember that prescription drug misuse is a problem that affects many Canadians and is not limited to First Nations, the Department does recognize the seriousness of the issue. It has established working groups to develop strategies and has initiated procedures to review prescription drug use in various regions. However, action to intervene has been slow.

13.110 According to the Department, a major reason for its inability to take prompt action was that systems were not sufficiently developed to analyze the pharmacy claims database. A departmental interdisciplinary working group on prescription drug abuse recommended in September 1988 that the prescription drug claims-processing system be automated and screening criteria be developed to monitor prescription drug use.

13.111 However, Health Canada's automated claims-processing system was not fully operational in all regions for the pharmacy component until July 1993. As the system was designed mainly to process claims, some Branch regional officers noted their repeated frustration that the NIHB program had been able only to pay bills rather than to help provide solutions to the prescription drug abuse problem.

13.112 Not until 1996 did Health Canada start to develop software to analyze prescription drug use. Drug use review activities were piloted in three Medical Services Branch regions in 1996 and

confirmed the nature of the problem. However, these reviews have been retrospective and have not facilitated timely intervention.

13.113 Health Canada's intervention is primarily in the form of notification to physicians, pharmacists and professional bodies; it does not contact the NIHB client at all. Some NIHB clients continue to have access to large amounts of prescription drugs. We believe that contacting the client could have a deterrent effect and could potentially encourage changes in the client's behaviour. It would also present an opportunity to provide help and information to those faced with addiction problems.

13.114 In cases where it identifies a significant pattern of inappropriate use of prescription drugs, the Department should perform a more rigorous follow-up with NIHB clients, physicians, pharmacists and professional bodies.

Department's response: Agreed. A protocol has been developed to guide departmental staff to follow up on patterns suggestive of prescription drug misuse.

Need for comprehensive solutions

13.115 In an attempt to address program weaknesses, Health Canada is currently testing a point-of-service system that is to be fully implemented in the fall of 1997.

13.116 Point-of-service systems for prescription drugs or pharmacy networks have been implemented by some provinces as a key mechanism to control drug use and administer benefits. Such a network can enhance patient care through more-informed decision making by the pharmacist, reduce fraud and the overconsumption of prescription medications, and improve claims adjudication.

13.117 In such a network, when a pharmacist enters the details of a prescription on an in-store computer, the information is transmitted electronically to a central system that assesses the prescription against the patient's recent medications. The system generates warning messages such as drug-to-drug interactions, overmedication, visits to several doctors and pharmacy shopping. Some systems also provide a full profile of all recent medications dispensed to an individual during, for example, the previous 14 months. Pharmacists are required to respond to warning messages and decide whether intervention is necessary. Some provinces offer an incentive for this, such as paying a double dispensing fee to compensate providers for professional services in cases where they have not filled a prescription for valid reasons.

13.118 The system being tested by Medical Services Branch will provide a set of system-generated messages and warning codes. It will also provide the dates of the last three prescriptions of the NIHB client. Pharmacists are expected to make dispensing decisions in response to warning messages, and the system will allow overrides.

13.119 The planned system will not provide a patient's full drug profile or complete information on doctors visited at the time of dispensing. Management notes that there are difficulties that would delay implementation of this feature nationally; however, it intends to strengthen the warning messages issued to pharmacists. Because the system will allow pharmacists to override warning messages, Health Canada will need to monitor this closely. The Department also needs to consider providing incentives to pharmacists to encourage appropriate intervention.

Health Canada is currently testing a point-of-service system for prescription drugs.

Because the system will allow pharmacists to override warning messages, Health Canada will need to monitor this closely.

Health Canada will need to be concerned about additional problems potentially generated by controlling access to prescription drugs under this program.

13.120 In implementing the point-of-service system for prescription drugs, the Department should ensure that the system will facilitate timely intervention where potentially inappropriate prescription drug use is identified. The Department should provide a clear protocol to guide intervention and should closely monitor pharmacists' overrides of warning messages.

Department's response: Agreed. The real-time pharmacy point-of-service system will be installed nationally by the end of 1997. A systematic audit of overrides will be used to gauge compliance and follow-up measures will be developed to deal with situations where compliance problems are identified. Payment incentives for pharmacists who decline to fill prescriptions in response to the alerts will be discussed during fee negotiations with provincial pharmacy associations. Despite the complexities associated with developing a fully portable, national system, the Department believes that this system will be superior to that of almost every other comparable provincial or private plan in the country.

13.121 Full implementation of a point-of-service system will not in itself solve prescription drug misuse problems. Tightening up controls is only one aspect. Health Canada will need to be concerned about additional problems potentially generated by controlling access to prescription drugs under this program.

13.122 Health Canada needs to examine the implications and resource requirements for community health programs with respect to treatment, community education and prevention of prescription drug addiction in First Nations communities. Prescription drug addiction has created other health problems, and the Department is concerned that many First Nations

individuals have a combined drug and alcohol problem. Treatment in one area may aggravate the problem in the other. In addition to detoxification, patients may require further treatment and aftercare. Training community health workers to deal with prescription drug abuse is also important.

13.123 The Department should build on its existing strategies to address the combined problem of prescription drug and solvent and alcohol abuse, and increase efforts in community health programs relating to prevention, community education, and treatment of prescription drug addiction.

Department's response: Agreed. The Department is developing educational materials to inform First Nations and Inuit people of the correct use of prescription drugs and to alert them to the problems of prescription drug misuse. An educational video on this subject will be distributed to all First Nations and Inuit communities by the end of 1997–98.

Overservicing by dental care providers

13.124 Another major NIHB benefit is dental care. Dental expenditures increased from \$74 million in 1990–91 to approximately \$123 million in 1995–96. The dental benefit is governed by a schedule of dental services that sets out frequencies for various services.

13.125 We found that the dental care providers tend to provide services up to the established frequencies and limits rather than based on needs, resulting in overservicing of some NIHB clients.

13.126 In 1995–96, one Medical Services Branch regional office set up a joint quality assurance committee with a provincial dental body. The committee analyzed the profiles of a number of dental care providers and believed that overservicing by certain providers was

occurring. Departmental data showed that levels of dental services by these providers were often many times above those of an average practitioner in that province. Some examples are shown in Exhibit 13.16.

13.127 In January 1996, Health Canada introduced changes to its benefit schedule by establishing revised frequencies and limits, in an attempt to control costs while maintaining the provision of high-quality dental care. Some of these changes were made in response to concerns about overservicing. The changes were implemented nationally. However, the Manitoba regional office indicated that the changes had been proposed unilaterally with little input from First Nations, and that they were contrary to common means of controlling costs used by other dental plans.

13.128 A predetermination process based on needs was piloted in Manitoba in April 1996. It requires prior approval and a treatment plan for performing dental services above a prescribed threshold amount. The needs-based approach is to ensure that First Nations clients receive the dental care they require. Preliminary results showed substantial cost savings. Management estimates that these savings, combined with those generated by the changes to the benefit schedule, will result in a 15 percent reduction of dental costs in 1996–97.

13.129 In January 1997, the departmental Dental Care Advisory Committee, which includes representatives from the First Nations and professional bodies, recommended that senior management approve the use of the predetermination model nationally by the end of 1997 as an intermediate solution. The Committee believes that this would provide the stability and time required for

the Department to consider further improvements. Branch senior management subsequently agreed to implement such a model in all regions except Ontario, where the issue is still being discussed.

13.130 In our view, a predetermination process requiring prior approval and a treatment plan provides a good control framework for dental benefits. We noted that it has been used by other dental plans and endorsed by the profession in some provinces. In 1996, we reported that Veterans Affairs had implemented such a process for its dental care program and achieved significant savings.

Overbilling of services by providers

13.131 We expected to find adequate systems and controls in place for the verification of claims and audits of pharmacy and dental care providers to provide assurance that expenditures have been made for the purposes intended.

13.132 Claims for prescription drugs and dental services submitted by pharmacy and dental care providers are processed using an automated claims-processing system managed by Health Canada's contractor. The contract, implemented in 1990, expires in June 1998.

Examples of dental services provided to First Nations clients in one province in 1994–95:

- One dental provider billed \$25,000 for
 58 root canal therapy procedures, about
 12 times more than an average practitioner performed in the province.
- Another provider charged \$40,000 for 92 crowns, more than six times the provincial norm.
- A dentist claimed \$27,000 for 356 coloured surface restoration procedures, about 40 times the average for such procedures performed by a dentist in the province.

Exhibit 13.16

Overservicing of Dental Procedures

The audits of providers conducted by the contractor did not provide a reasonable degree of assurance that expenditures were made for the purposes intended.

- 13.133 According to the statement of requirements in the contract, the contractor is required to "provide audit control on health service providers for the purpose of detecting and dealing with billing irregularities." Also, the contract states that there must be a method of verifying the integrity of the process to ensure that prescribers and providers are legitimate and that services paid for by Health Canada have in fact been received by NIHB clients. However, the contractor does not perform any procedures to confirm that benefits have been received by clients.
- 13.134 Edits are in place to identify apparent duplicate claims. Management believed that these edits were designed in such a manner that they would identify and alert management to any potential duplicate payment. However, we identified over 5,500 claims that appeared to have been paid twice (with a potential overpayment of \$166,510) in the year 1996. We also identified 160 transactions in a three-month period that suggested that the same prescription was filled at more than one pharmacy on the same day. Management recognizes these weaknesses and is now attempting to have the contractor strengthen these systems controls and edits.
- 13.135 Although the contract was initiated in 1990, no audits of providers were undertaken before the summer of 1995. Of approximately 6,500 pharmacies and 18,000 dental care providers, only 47 pharmacy audits and 13 audits of dental providers were performed over 18 months in 1995 and 1996. Some planned audits of dental care providers were not carried out because of providers' concerns about the contractor's right to audit them.
- **13.136** All audits of dental care providers found questionable billings. One audit, which found that a dentist had

- inappropriately charged for tooth extractions and other procedures, resulted in a repayment of approximately \$20,000 to Health Canada. Another provider repaid the Department over \$15,000, billed for a specific or emergency examination along with routine procedures such as preventive cleaning. In addition, a review by one Branch regional office led to the conviction of a dentist for billing both the Department and a provincial plan for dental treatment to NIHB clients covered under both plans. This resulted in a repayment of more than \$30,000 to Health Canada.
- 13.137 Approximately 90 percent of the pharmacy audits performed found errors and discrepancies such as duplicate claims, lack of documentation for verbal prescriptions and questionable record-keeping practices. Some cases involved suspected fraudulent practices that were referred to the appropriate authorities for investigation. One case resulted in restitution of more than \$77,000 from the provider.
- **13.138** We found that the audits of providers did not provide a reasonable degree of assurance that expenditures were made for the purposes intended. The audit strategy was not based on an appropriate assessment of risks. Audits were targeted mainly at a small number of high-volume providers. The Department believes that it is very difficult to require the contractor to increase the audit effort, due to the vagueness of the contract's wording. Because of the limited audit coverage, it is not possible to determine the full extent of errors and overpayments. However, the findings raise serious questions about the potential loss of public money.
- 13.139 Audits of providers are intended to be a key control relied on by Health Canada to ensure that payments are

properly made for benefits and services received by its clients. Therefore, it is important that the requirement in the contract is clear, that the Department knows what is being done and what errors are being found, and that, as appropriate, it adjusts its reliance on the work of the contractor.

13.140 Health Canada should clarify, and enforce, the contract requirement for audit of pharmacy and dental care providers by the contractor. The Department should take appropriate steps to improve claims-processing system controls and edits and strengthen verification of claims and audits of providers.

Department's response: Agreed. In common with other plans, there must be an assessment of the risk in order to strike a balance between ensuring client access to necessary therapies and control of potential abuse. Improvements have been made to the audit portion of the new claims-processing contract, to be in place by July 1998. The Department is investigating the claims-processing errors identified by the Auditor General and is instituting immediate corrective measures. Efforts are under way to improve verification of claims and provider audits under the existing contract.

Opportunities to improve efficiencies in medical transportation

13.141 Medical transportation expenditures increased from approximately \$85 million in 1990–91 to almost \$150 million in 1995–96. The benefit includes transportation to receive health services that cannot be obtained on-reserve, medical transportation from isolated communities, emergency transport to non-elective care, and community-based transportation to the nearest major centre. Approximately 60 percent of transportation expenditures

are administered by Medical Services Branch regional offices with payments made directly to providers by Health Canada. The other 40 percent of expenditures, mainly for local medical transportation, are administered by First Nations communities on behalf of the Department under contribution agreements.

13.142 There are many grey areas in the national directives on transportation, which have led to different interpretations and applications by Branch regional offices. We found inconsistencies in the requirement for certification of attendance at a doctor's appointment and in payment for similar items in different regions.

13.143 Ambulance costs accounted for substantial expenditures in some regions. At the time of our audit, there was no rigorous ongoing monitoring of these expenditures. Departmental officials in some regions have undertaken ad hoc reviews of ambulance costs, the results of which confirm the need for tighter control.

about \$8 million in 1995–96 for services to approximately 125 ambulance companies. A regional internal review of invoices submitted by three ambulance companies found many cases of inflated distances, invoices received for individuals not eligible for coverage, an inappropriate surcharge of \$100 being levied on First Nations members living off-reserve, and ambulances used as taxis rather than for emergencies.

13.145 Another regional office also performed a limited review of ambulance costs, which identified cases of potential abuse that had gone undetected. In one such case, a client had taken 150 ambulance trips costing over \$21,000 during a five-month period. No

Improvements are required in management practices and in the control of medical transportation costs.

Any transfer initiative of the Non-Insured Health Benefits program must recognize the weaknesses identified and assign responsibility for fixing them.

one had questioned the trips until they were identified by the internal review.

13.146 While expenditures administered by First Nations communities under contribution agreements are often audited, transportation expenditures paid directly by Medical Services Branch to transportation providers have not been subject to any departmental audits in recent years.

13.147 Management is aware that improvements are required in management practices and in the control of medical transportation costs. For example, some regional program managers agreed that there is a need for better co-ordination of trips to achieve efficiencies.

13.148 Health Canada believes that transportation efficiencies can best be achieved at the community level. It has proposed moving medical transportation funding from the NIHB program to community health budgets. Such a change will require clear program criteria and mandatory elements, standards and audits.

13.149 Health Canada should establish clear program criteria and minimum standards for medical transportation benefits. It should also undertake audits of medical transportation expenditures based on an assessment of risks.

Department's response: Agreed. The Department is pursuing a course of action to address these problems. Cabinet has approved the move of medical transportation from NIHB to community programs. The requirement to establish program criteria and minimum standards will be addressed as the management framework is developed. This will be done in consultation with First Nations and Inuit groups. The Department will also increase the audit activity with regard to medical transportation.

Need to resolve systemic problems before transfer of NIHB program

13.150 In 1995, Medical Services
Branch planned to implement 30 pilot
projects across Canada over a two-year
period to test various future management
options for the NIHB program, including
management by the communities. To date,
22 proposals have received a negotiating
mandate but few have been approved for
pilot implementation. Only one pilot is
under way.

13.151 As already described, significant systemic problems and weaknesses exist in the program, particularly relating to prescription drugs and dental benefits. There are also other important issues that need to be addressed, including concerns of off-reserve clients and small communities, sustainable funding and the impact of the delisting of provincial insured services. In addition, Health Canada needs to evaluate the results of the transfer pilots.

13.152 As noted earlier, planning to transfer the NIHB program to First Nations control is under way. In our view, any transfer initiative must recognize the weaknesses identified and assign responsibility for fixing them.

Important concerns remain from previous audit

13.153 In our 1993 audit of the Non-Insured Health Benefits program, we examined the mandate, management practices and operational controls of the program.

13.154 We reported that the absence of specific enabling legislation for the program left a gap in the definitions of purpose, expected results and outcomes of program benefits. We recommended that the Department seek from the government a renewed mandate for the program to

clarify the authority base, purpose and objective of the program.

13.155 We also noted that the Department had problems in implementing the principle of "payer of last resort". Health Canada paid for benefits that it should not have because First Nations clients involved were not fully obtaining the benefits available from other plans. This section contains our observations as a result of the follow-up.

13.156 Program mandate. The renewed policy mandate proposed in 1997 defines the nature of the program, including its purpose and objective as well as the principles governing it. However, it does not address the need to clarify the authority base for the program. There is still no specific legislation recognizing non-insured health benefits. Further, the Department has yet to identify expected results of program benefits.

13.157 Principle of payer of last resort.

The Department has noted that the principle is difficult to enforce in the absence of enabling legislation and given that provincial and private health insurance plans also claim to be payers of last resort. In practice, declaration of third-party coverage by NIHB clients is entirely voluntary and it is left to the service provider to identify any such coverage. A recent departmental audit suggested that there is a significant gap between the number of NIHB clients who have other coverage and the two percent of clients who actually declared other coverage when they received NIHB benefits.

13.158 A departmental working group has proposed several recommendations with a view to addressing our 1993 concerns. A number of them are currently being implemented. However, the working group is of the opinion that substantive

improvements in the co-ordination of benefits with other insurance plans will be realized only when issues relating to treaty rights have been resolved.

13.159 The new program mandate proposes that where a benefit is covered under another plan, Health Canada will act as the "primary facilitator", co-ordinating payment to ensure that the other plan meets its obligations and that clients are not denied service. However, the Department indicates that the proposed principle does not detract from its position that NIHB is the payer of last resort. Nor does it expand or limit different understandings of federal responsibilities under the "fiduciary relationship".

13.160 Management information systems. In 1993, we reported that the NIHB program lacked the information systems and capabilities necessary to monitor and analyze patterns of benefit expenditure and use. The Department has applied considerable effort to improve its ability to monitor patterns of use of pharmacy and dental benefits. However, we found that the Department still did not have adequate systems to monitor and analyze these patterns for medical transportation and allied health care benefits.

Department's comments: Over the past three years, the Department has commissioned three separate evaluations of the program and has drawn on the recommendations of these studies to design its current cost management approach. In the past six years, the Department's cost management measures have achieved a total saving of more than \$1.3 billion. This has been achieved without diminishing in any significant way the level or quality of the benefits, despite the upward pressure of a client base growing at twice the rate of the Canadian

Health Canada is taking action to address our 1993 observations and recommendations. population and the increasing costs of such benefits as prescription drugs.

Since 1993 the Department has taken a number of very important steps in order to address the problem of prescription drug misuse. These include the development of a fully automated claims-processing system, authorization to exchange information on possible irregularities with professional disciplinary bodies, establishment of a Drug Utilization Review Committee, which, among other things, has developed a protocol to identify patterns of possible misuse, and development of a software system to analyze patterns of prescription drug usage. We believe that the Department has been at least as active, and in some cases more active, than the managers of similar programs in taking advantage of new technology to improve the management of the system.

The Department has addressed all three of the recommendations from the 1993 audit. Work continues on ways to improve co-ordination with provincial and other third-party payers. In 1993 we stated that we would seek Cabinet approval of the program's mandate and this was obtained in April 1997. It is the Department's view that, through Cabinet, the authority base of the program has been clarified.

Conclusion

13.161 Follow-up. Health Canada is taking action to address our 1993 observations and recommendations. However, the Department needs to further improve its management information systems and co-ordination of benefits.

13.162 Community health programs. Based on our examination of programs delivered under separate contribution agreements, we found that once the contribution agreements are signed, the link between the Department and the community tends to disappear. The

contribution agreements are viewed primarily as a means of transferring funds and, to a lesser extent, as an agreement between the two parties on the provision of health services to the First Nations population, for which the Department remains accountable. The Department is not fulfilling its responsibilities to manage in a way that helps First Nations establish programs and services likely to improve their health. There is a need to monitor contribution agreements in a way that will give First Nations flexibility and control to tailor programs to meet community needs and, at the same time, fulfil the Department's obligations.

13.163 Transfer agreements. We found that a sound framework for transfer has been developed but not yet fully implemented, leaving some gaps and deficiencies. More focus on achievements related to health is needed, in both the planning and reporting phases. Sound monitoring is needed to make sure that the management practices put in place in the pretransfer stage continue to evolve, and that the required reports are produced and provide the necessary information. These are needed to meet the accountability obligations of First Nations and the Department and also to improve the programs and services.

13.164 Non-insured health benefits. We found that NIHB program expenditures are not well managed and, in most areas, not properly controlled. Benefits are subject to abuse by users and providers, and systems and controls, including verification of claims and audits of providers, are inadequate. In particular, the Department needs to deal with the serious implications for First Nations health and the consequences of not having a properly controlled system in place.

13.165 It is vital to put proper controls in place to ensure appropriate use of the

benefits and prudent use of public funds. There is also an urgent need for comprehensive solutions to address the abuse of the prescription drug system, through better use of information technology and concerted efforts with physicians, pharmacy providers and First Nations. Before any consideration is given to transferring NIHB to First Nations control, these systemic problems will need to be resolved.

13.166 A final note. The current trend in Health Canada is to continue devolution and to move out of health care service delivery. Many First Nations members are concerned about a "dump and run" approach: they are worried that First Nations will be left on their own without having acquired the needed capacity to design and manage these important programs and without support from Medical Services Branch.

13.167 Improving the health of First Nations is a complex task. There are many governments involved and many factors that affect health outside of the

health care services. This audit examined only the programs that the Medical Services Branch of Health Canada delivers either directly or in partnership with First Nations organizations. The chapter therefore presents only a part of the total picture. We believe that improving the programs in the ways we have recommended would contribute to improving the health services and thereby the health of First Nations.

Department's comments: The Department is aware that some First Nations people are concerned that we intend to take a "dump and run" approach to devolution and transfer. The mission statement of Medical Services Branch states that "First Nations and Inuit people will have autonomy and control of their health programs and resources within a time frame to be determined in consultation with First Nations and Inuit people." The approach of Health Canada has been, and will continue to be, one of caution and assurance that First Nations communities feel, and are, ready to take on responsibility for their health programming before transfer occurs.



About the Audit

Objectives

- To determine whether Health Canada manages First Nations health programs in an efficient and effective manner.
- To determine whether an appropriate accountability framework is in place for the transfer of health services to community control.

Scope

The audit covered Health Canada's health programs directed at First Nations, including community health programs delivered through separate contribution agreements, transfer of health programs to community control and Non-Insured Health Benefits (NIHB).

With respect to community health programs delivered to First Nations using separate contribution agreements, we performed a detailed analysis of a sample of agreements involving 40 communities. We reviewed the transfer framework and a sample of 24 transfer agreements. The selection in both cases was made to reflect communities of different regions, sizes and degrees of isolation. We reviewed systems, controls and management practices relating to the delivery of non-insured health benefits and undertook a follow-up of recommendations reported in Chapter 19 of our 1993 Report, on the NIHB program. We carried out extensive interviews with program managers at Medical Services Branch headquarters and selected regional offices and with selected representatives of First Nations communities and professional bodies. In addition, we reviewed program documentation and related health literature.

We did not examine the management of hospitals and other health facilities and environmental health, nor did the audit cover activities in the two territories. We did not audit the integrated agreements because they were developed in 1994 and only a small percentage of First Nations had signed such agreements at the time of our audit.

The quantitative information in this chapter that has been drawn from government sources or departmental databases has been checked for reasonableness but has not been audited.

Criteria

- The community health programs should be designed to facilitate the achievement of objectives in an
 efficient and effective manner.
- Agreements with First Nations communities for the delivery of community health programs should clearly specify the objectives and activities to be undertaken and the corresponding reporting requirements. There should be monitoring of the implementation of these agreements to ensure compliance and that departmental obligations are met.
- There should be an adequate framework for the transfer of health programs to community control to:
 - ensure that clear health objectives and expected results to be achieved are established;
 - ensure that capacity is aligned with responsibilities;

- ensure compliance with requirements of the agreements;
- monitor performance reporting; and
- report results of transfer in terms of changes to the health of First Nations.
- The Department should have taken action in response to the recommendations contained in the 1993 chapter relating to Non-Insured Health Benefits.
- The Department should have systems, controls and strategies in place to identify, assess and respond to major risk areas in the Non-Insured Health Benefits program.

Audit Team

Christina Brooks Sylvie Cantin Gerry Chu Joanne Moores Jean Petitclerc

For information, please contact Ronnie Campbell, the responsible auditor.



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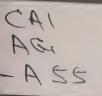
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Atlantic Groundfish Fisheries

Chapter 14

Fisheries and Oceans Canada – Sustainable Fisheries Framework: Atlantic Groundfish

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Human Resources Development Canada – The Atlantic Groundfish Strategy

This October 1997 Report comprises 11 chapters and a Foreword and Main Points. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

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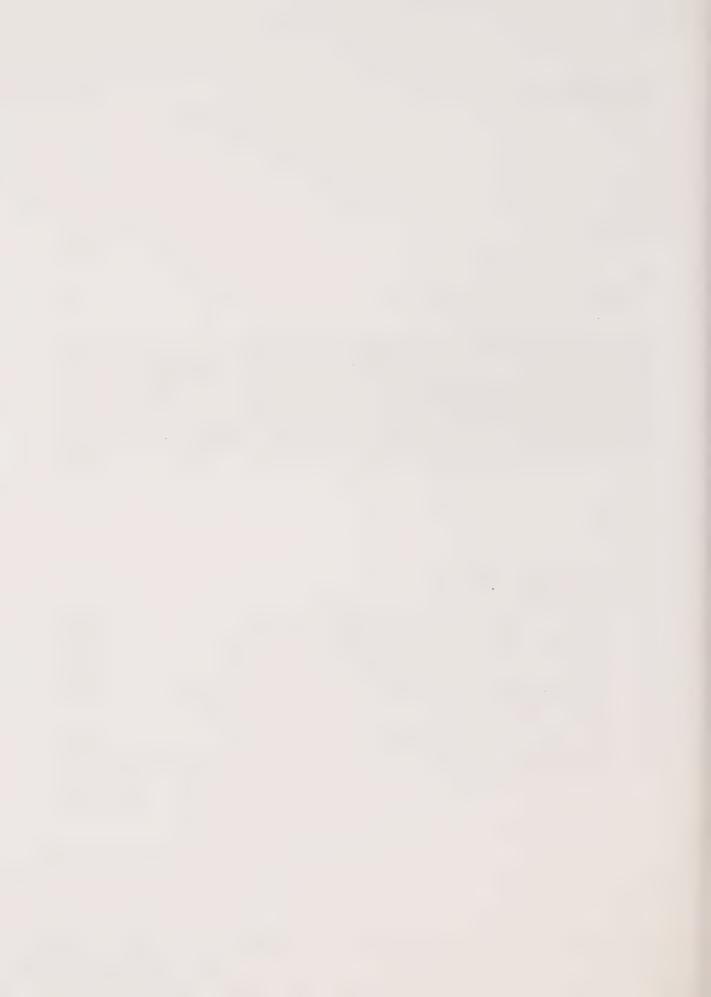
Chapter 14

Fisheries and Oceans Canada — Sustainable Fisheries Framework:
Atlantic Groundfish

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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Assistant Auditor General: Don Young Responsible Auditor: Doug Timmins

Fisheries and Oceans Canada — Sustainable Fisheries Framework: Atlantic Groundfish

Main Points

- 14.1 Although many Atlantic fisheries continue to thrive, the 1990s saw the collapse of most of Atlantic Canada's commercial groundfish fishery. As Atlantic groundfish stocks headed toward their lowest levels in recorded history, Fisheries and Oceans Canada and the Northwest Atlantic Fisheries Organization progressively closed most of the commercial Atlantic groundfish fisheries and significantly reduced the total allowable catch for others.
- 14.2 To address this situation, the federal government implemented income support and adjustment programs to help those dependent on the fishery and also undertook specific initiatives designed to improve fisheries resource management and bring industry capacity into line with the size of the groundfish resource. The government will have spent over \$3 billion of new and reallocated program funds this decade. While some progress has been made, many of the critical problems related to the fishery remain, particularly the excess capacity to catch fish, and the number of people relying on the fishery and associated income support programs remains high.
- 14.3 Managing the seasonal and labour-intensive Atlantic groundfish fishery on a sustainable basis is extremely challenging. Decision makers face the imprecision inherent in determining the status of fish stocks as well as pressure from fishers, plant workers and industry to maintain access to and income from the fishery, access to employment insurance during the off-season, and access to alternative forms of government support in times of crises.
- 14.4 Although Fisheries and Oceans Canada has stated principles for a fishery of the future, measurable indicators to assess progress are required. While progress has been made in reducing the number of groundfish licences, excess harvesting capacity in terms of an ability to kill fish remains. The Department needs to further its efforts to identify the extent of the contribution of environmental and other factors to the decline of the groundfish. In addition, fisheries management practices need to be further improved to better manage the risks and uncertainty inherent in managing the fishery as a sustainable resource. A precautionary approach to conservation must be the priority and unsustainable fishing practices need to be addressed.
- 14.5 The Department has stated that its mandate is conservation of the fishery resource base and that this is implied in current legislation. Nevertheless, we found no clearly stated national policy for sustainable fisheries. In addition, performance indicators need to be further developed and planning and performance reporting processes need to be better integrated.
- 14.6 The deep cultural attachment to the groundfish fishery has been reinforced by several decades of government subsidies. This has resulted in substantial pressure on government to maintain the status quo; that is, to use the fish as a basis for providing income support. Successive governments have provided increasing income support for the people living in the remote coastal communities in Atlantic Canada. This reaction to social pressures has not resulted in an economically viable fishery. In fact, the absence of the fishery has revealed, more clearly than ever before, the substantial reliance on income support by a significant portion of the Atlantic fishing industry. This reliance makes dealing with already complex problems of overcapacity and fisheries management more difficult.

Main Points (cont'd)

14.7 With the future of groundfish uncertain, the problems remain critical. In our view, the Department, in conjunction with the government, needs to take further steps to implement the principle that "conservation is the paramount priority", as well as to continue to pursue efforts to ensure that resource management decisions reflect the principle that "harvesting capacity must match the available resource base." At the same time, the government must deal with difficult socio-economic decisions about the future of those whom the fishery cannot support, if fisheries management is to ensure an ecologically and economically sustainable fishery.

Introduction

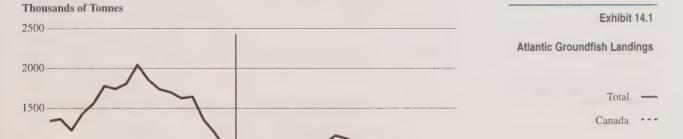
14.8 The 1990s saw the collapse of most of Atlantic Canada's commercial groundfish fishery (Exhibit 14.1). As Atlantic groundfish stocks headed toward their lowest levels in recorded history, Fisheries and Oceans Canada and the Northwest Atlantic Fisheries Organization progressively closed most of the Atlantic commercial groundfisheries and significantly reduced the total allowable catch in others. The majority of these fisheries currently remain closed.

14.9 Groundfish, at a harvestable age, are associated with the ocean bottom for the most part. Examples include cod, haddock, pollock, halibut and various flatfish. Groundfish constitute one of the three major Atlantic Canadian commercial catches. The others include shellfish such as shrimp and lobster, and pelagics such as herring and mackerel. While the 1990s saw a decline in groundfish landings, shellfish fisheries experienced significant growth and pelagic fisheries remained stable.

1000

14.10 The decline of groundfish stocks was dramatic. From domestic and foreign annual total catches of 2,000,000 tons in the 1960s, groundfish landings fell to approximately 120,000 tons a year after the collapse. Historically, groundfish had represented two thirds of the entire Atlantic catch tonnage and 40 percent of its landed value. In certain years prior to the collapse, the 600,000 tons of groundfish landed annually by the Canadian fleet had a value of \$350 million and supported over 40,000 fishers and plant workers in hundreds of communities in eastern Canada. They also generated spin-off benefits to other workers in those communities.

14.11 The labour-intensive and predominantly seasonal work provided tens of thousands of Atlantic Canadians income from fishing-related activities and qualified many for unemployment insurance payments during the off-season. Many Atlantic Canadians living in areas without alternative sources of employment faced losing both of those sources of income under progressive moratoria on groundfish, beginning in 1992. Their stark situation contrasted with a smaller number



Extension of Jurisdiction

Total includes foreign catches outside the 200-mile zone on straddling stocks and on Flemish Cap.

1960 1963 1966 1969 1972 1975 1978 1981 1984 1987 1990 1993 1996

Source: Fisheries and Oceans Canada

Fisheries and Oceans Canada – Sustainable Fisheries Framework: Atlantic Groundfish

These programs will have cost Canadian taxpayers over \$3 billion during the 1990s.

of their neighbours in the more thriving shellfish industry, where high landings and prices fuelled prosperity.

The social and economic impacts of the moratoria would likely have been much greater had it not been for government intervention through a number of programs. The federal government launched a series of reviews, implemented income support and adjustment programs and undertook initiatives designed to bring the industry's capacity into line with the size of the groundfish resource. In the end, these programs will have cost Canadian taxpayers over \$3 billion during the 1990s. The most recent of these programs, The Atlantic Groundfish Strategy, is providing \$1.9 billion to address income support and adjustment (\$1,748 million), rationalization of capacity (\$97 million) and economic development (\$50 million). The Strategy is a joint program of Human Resources Development Canada, Fisheries and Oceans Canada, the Atlantic Canada Opportunities Agency and the Federal Office of Regional Development -Ouebec.

Focus of the audit

14.13 The Office has addressed these issues in a series of three chapters. This chapter sets the stage for the following two chapters on Atlantic groundfish by describing the environment leading up to the groundfish decline and the subsequent response. It provides a synthesis of studies and analyses on how the fishery evolved to a state of commercial moratoria. The chapter also reports on the progress of Fisheries and Oceans Canada toward a sustainable management framework and summarizes the conclusions of all three chapters for the reader.

14.14 Chapter 15 reports on progress of the fisheries management practices in dealing with the fundamental problems of the Atlantic fishery. Both chapters 15 and 16 report on whether income support, capacity rationalization and adjustment programs administered by Fisheries and Oceans Canada and Human Resources Development Canada have contributed to the achievement of both fisheries management objectives and The Atlantic Groundfish Strategy objectives.

Chapter 16 also reports on whether an

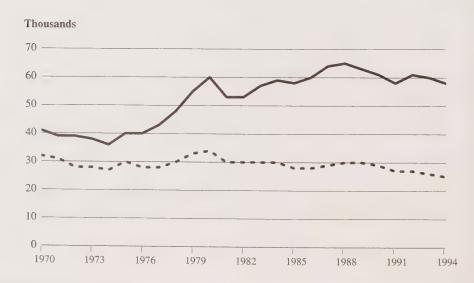


Registered Fishing Vessels and Fishers – Atlantic

- Fishers

--- Vessels

Source: Fisheries and Oceans Canada



effective accountability regime for The Atlantic Groundfish Strategy has been established.

14.15 Further details are provided in **About the Audit** at the end of the chapter.

Observations and Recommendations

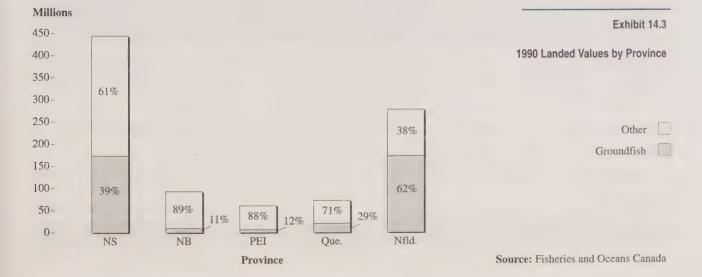
14.16 One quarter of Canada's Atlantic coast residents live in 1,300 fishing communities, half of which depend entirely on the Atlantic fisheries for their existence. Prior to the groundfish collapse, the Atlantic fisheries accounted for 4.2 percent of employment in Atlantic Canada.

14.17 In 1994, Fisheries and Oceans Canada reported that Atlantic Canada had more than 25,000 registered fishing vessels and about 58,000 registered fishers, about 45,000 of whom were active in the various Atlantic fisheries (Exhibit 14.2). In 1996, Atlantic Canada had 832 federally registered fish processing plants, 741 of which were active.

The groundfish industry has played a significant role in the economies of the four Atlantic provinces and Quebec (Exhibit 14.3). In Newfoundland, for example, the groundfish catch in 1990 represented about 62 percent of the total catch's landed value; historically, the groundfish industry provided about 16 percent of Newfoundland's employment. By comparison, in Nova Scotia, groundfish represented approximately 40 percent of the landed value and about six percent of employment. Quebec and the other Atlantic provinces are involved in the groundfish industry to a more limited extent. In 1997, there were 13,061 groundfish licences in Atlantic Canada. This figure includes 2,626 non-reissuable licences that are planned to be eliminated over time.

Collapse of the Atlantic Groundfish Industry

14.19 The current crisis in the health of groundfish stocks throughout Atlantic Canada first emerged in the 1980s and early 1990s. The collapse began with the northern cod stock off the coast of Newfoundland and Labrador —



Fisheries and Oceans Canada – Sustainable Fisheries Framework: Atlantic Groundfish

historically, a third of the groundfish catch
— and then broadened to most other
groundfish species throughout Atlantic
Canada.

The Minister of Fisheries and 14.20 Oceans closed the northern cod fishery in July 1992. It became clear that key biological indicators were declining rapidly and that the biomass of many groundfish stocks was at the lowest level ever observed. Not only were the stocks declining, but the individual fish were growing more slowly: for example, in four management zones, the weight of individual cod at age seven had decreased significantly between 1977 and 1993. The Fisheries Resource Conservation Council was set up by the Minister of Fisheries and Oceans to provide advice on fishing levels under these conditions. The Council first reviewed the status of groundfish stocks in 1993. It concluded that fishing of many of the groundfish stocks should be stopped to allow them to rebuild.

Impact of the groundfish moratoria

14.21 A substantial amount of processing is required to bring the groundfish product to market; thus, the collapse of the groundfish industry affected not only fishers but an even higher number of people who worked in processing plants.

14.22 Groundfish workers constitute a largely rural and isolated population; the communities where they live offer few alternative sources of employment and rates of unemployment are high. Even if the communities had alternative employment opportunities, many of those involved in the groundfish industry have low levels of education (Exhibit 14.4) and lack experience outside the fishery. Furthermore, many own homes, have strong community ties and strongly believe that the groundfish will return.

14.23 Income from unemployment insurance has provided a significant and increasing portion of fisher income over

Exhibit 14.4

1991 Survey of Atlantic Fishers – Educational Profile (in percentage)

			drog est			vince						
Characteristic	N	IS	N	В	P	EI	Q	ue.	Ni	ld.	Atla	antic
	Total	Active	Total	Active	Total	Active	Total	Active	Total	Active	Total	Active
No formal education	1.4	1.1	1.7	0.5	0.9	0.8	1.1	1.4	2.5	2.7	1.8	1.7
Elementary	29.4	30.3	33.6	34.2	25.7	22.8	26.4	23.8	34.9	35.8	31.7	31.8
Some secondary	44.8	45.9	33.1	39.0	46.1	48.0	44.4	47.6	45.6	45.2	43.7	45.1
Completed secondary	15.4	13.5	21.4	15.6	20.8	22.4	20.0	18.7	9.5	9.9	14.8	13.6
Trade/vocational	3.2	3.5	4.9	4.4	1.3	1.1	3.1	3.3	2.9	2.7	3.1	3.0
Some college/completed	2.3	2.4	2.4	2.7	1.5	1.6	3.7	4.2	1.6	1.4	2.1	2.1
Some university/ completed	3.3	3.2	2.8	3.5	3.6	3.4	1.2	0.9	2.9	2.2	3.0	2.7
Total Fishers	16,576	12,767	8,523	5,216	5,702	4,652	5,380	3,467	24,921	19,129	61,102	45,230

Source: Fisheries and Oceans Canada

the years. In 1981, for example, for every dollar they earned in the fishery, self-employed fishers received 43 cents in unemployment insurance benefits; by 1990, this had risen to 81 cents. For plant workers, the increase was from 33 cents to 57 cents. (Exhibit 14.5)

- 14.24 The potential impact of the groundfish moratoria was greatest in Newfoundland, the province with the largest groundfish industry. Reliance on unemployment insurance payments was also highest there; by 1990, self-employed fishers were receiving \$1.60 in unemployment insurance benefits for every dollar earned in the fishery, up from 96 cents in 1981.
- 14.25 The combination of income from the fishery and income from unemployment insurance has proved to be more attractive than other alternatives, whether local or distant, and has allowed many Atlantic coastal communities to maintain their population.
- 14.26 Without groundfish industry employment, however, many workers have been unable to find enough work to qualify for employment insurance (formerly unemployment insurance). The income support provided by The Atlantic Groundfish Strategy is nearing an end, the fish have not yet returned in sufficient quantity to sustain the industry, and many areas affected by the groundfish collapse still offer few other employment opportunities.

Causes of the Atlantic groundfish decline

14.27 Both fishing and natural causes contribute to total fish mortality. Fisheries and Oceans Canada has identified excessive harvesting as a major factor contributing to the groundfish decline, and has indicated that environmental

conditions and predator-prey relations were also contributing factors in certain areas.

- 14.28 The increase in fish harvesting over time is shown in Exhibit 14.6. This exhibit demonstrates fishing levels much higher than the Department's conservation standard. In many groundfish stocks such as cod, fishing at the conservation standard means catching about 2 out of every 10 fish available in a year, and leaving the remainder to reproduce and support a profitable fishery in future years.
- 14.29 Departmental officials have identified three factors in the overharvesting of groundfish stocks: the fishing levels were set above conservation standards, fishers caught more than they were allocated and certain fishers used unsustainable fishing practices.
- 14.30 Total fishing levels set above conservation standards. The Minister of Fisheries and Oceans sets out in annual plans the total allowable catch for fish stocks under management, and divides that total among user groups to ensure an orderly and equitable harvest. On occasion, these levels were set higher than the Department's conservation standard for fishing mortality.
- 14.31 The Department's science function prepares an assessment of the status of groundfish stocks on an annual basis. Prior to 1993, these assessments were subject to peer review by scientists on the Canadian Atlantic Fisheries Scientific Advisory Committee; since 1993, the science function provides these estimates to the Fisheries Resource Conservation Council, which then recommends target fishing levels to the Minister.
- **14.32** Given the difficulty arising from variability in marine environmental factors and sampling variation, these

The fish have not yet returned in sufficient quantity to sustain the industry, and many areas affected by the groundfish collapse still offer few other employment opportunities.

The total allowable catch was set higher, on occasion, than the conservation standard.

Exhibit 14.5

Average Income of Individuals from Selected Sources

					Self-Emp	Self-Employed Fishing	20					
	No. Em	No. Employed	Total Inc	Total Income (\$) *	Income from Fishery (\$)	me hery (\$)	Income from UI (\$)	me I (\$)	UI/J	Ul/Total Income (%)	UI/Fi	UI/Fishing Income (%)
	1990	1981	1990	1981	1990	1981	1990	1981	1990	1981	1990	1981
All Atlantic	34,410	38,850	19,300	11,900	8,100	5,800	009'9	2,500	34	21	81	43
Newfoundland	14,940	16,360	14,700	8,800	4,300	2,800	006'9	2,700	47	31	160	96
PEI	3,010	2,810	17,000	10,800	5,500	5,400	7,600	2,800	45	26	138	52
Nova Scotia	10,770	10,010	26,200	16,900	14,900	11,100	5,700	2,000	22	12	38	18
New Brunswick	3,350	3,640	20,400	13,400	6,800	5,900	6,500	2,700	32	20	96	46
Quebec	2,340	3,040	18,700	11,300	6,700	5,200	7,300	2,900	39	26	109	56
					Fishing	Fishing Processing						
	No. Employed	ployed	Total Income (\$) *	me (\$) *	Income from Fishery (\$)	me nery (\$)	Income from UI (\$)	ne I (\$)	Ul/Total Income (%)	UI/Total come (%)	UI/Fishing Income (%)	UI/Fishing Income (%)
	1990	1981	1990	1861	1990	1981	1990	1981	1990	1981	1990	1981
All Atlantic	58,710	57,210	15,900	009'6	8,200	6,100	4,700	2,000	30	21	57	33
Newfoundland	26,960	25,280	16,000	10,300	8,400	006'9	5,300	2,100	33	20	63	30
PEI	2,840	2,470	14,300	7,400	5,400	4,000	5,100	1,900	36	26	94	48
Nova Scotia	13,140	13,050	17,800	10,200	10,700	7,100	2,900	1,100	16	11	27	15
New Brunswick	11,650	11,610	14,000	8,200	6,400	4,400	4,600	2,500	33	30	72	57
Quebec	4.130	4 800	15 400	8 700	6 100	4 600	0000	0000	4			

* Includes income from the fishery, other employment, unemployment benefits and other transfers

Source: Task Force on Incomes and Adjustment in the Atlantic Fishery

assessments reflect a lack of precision. It became apparent in 1986 to departmental scientists and external reviewers that a continuing pattern of overestimation of groundfish stocks resulted in a fishing level for northern cod stocks at least double the Department's conservation standard.

14.33 Assessing fish populations is a very challenging endeavour for scientists in Canada as well as other countries. Assessment problems resulted from assumptions in the sequential population analysis prediction model used for many groundfish stocks; these reflected an incomplete understanding of the biology of stocks and suffered from limitations in the data. The Department's science function based its population assessments primarily on data collected from research survey cruises and on commercial fishery landing statistics. There was a time lag between the survey and the period for which assessments were made.

14.34 In the period prior to the groundfish collapse, although the research surveys indicated that some stocks were declining, the data on offshore

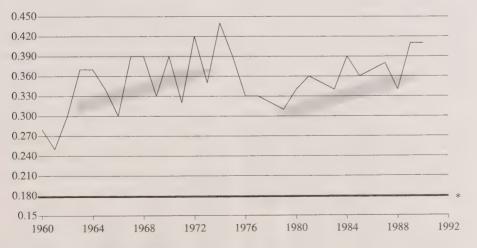
commercial fishing showed no such decline. Data on commercial fishing operations reflected the results of selective fishing by experienced captains with increasingly sophisticated electronics and gear, in areas of high fish concentrations. In addition, the information on stocks is also inaccurate, due to underreporting, misreporting or additional fishing mortality caused by unsustainable fishing practices, as discussed below.

The total allowable catch is the total tonnage of a particular fish stock allowed to be caught in a given year. In the years before the groundfish decline, the Minister reviewed scientific recommendations but, by convention, set the total allowable catch under decision rules that provided flexibility. One of these rules provided that the total allowable catch could be halfway between the current fishing mortality level and the target fishing mortality level for the next year. This flexibility served to moderate the socio-economic impact of year-to-year changes in the total allowable catch on a fishing industry with excess capacity; however, it proved to have negative impacts on declining stocks.

Exploitation Rate

Exhibit 14.6

Exploitation Rate of Major Cod, Haddock and Pollock Groundfish Stocks



^{*} conservation standard for stocks such as cod

Source: Fisheries and Oceans Canada

Fisheries and Oceans Canada – Sustainable Fisheries Framework: Atlantic Groundfish

Unsustainable fishing practices also contributed to the groundfish collapse.

14.36 Fishers caught more fish than allocated. Pressure on fish stocks was also due in part to the fishers catching more fish than the amounts allocated to them; for example, haddock landings for 1991 and 1992 were nearly double the total allowable catch. Occasionally, fisheries managers did not close fisheries until some time after the quota had been met, because they did not have available timely data on catches against quotas. Fishing by foreign fleets in the Northwest Atlantic Fishing Organization regulatory area immediately adjacent to the Canadian 200-mile limit was much higher than the Organization's conservation standard (Exhibit 14.7). "The Report on the Task Force on Incomes and Adjustment in the Atlantic Fishery" noted foreign overfishing of straddling stocks as a factor in the decline of cod stocks. Since that time, the Department has been actively advancing international conservation to protect groundfish stocks and reduce foreign overfishing.

14.37 Unsustainable fishing practices. According to Fisheries and Oceans Canada, unsustainable fishing practices

also contributed to the groundfish collapse. Those practices include unrecorded landings, misrecorded landings, dumping of bycatch and highgrading.

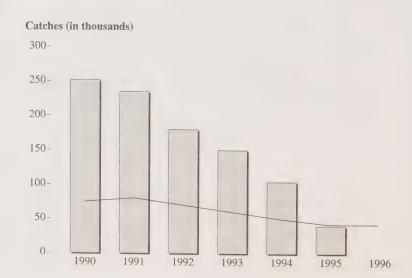
- Unrecorded landings can occur because of the desire of fish harvesters to maximize their return in a competitive fishery and because of limitations and weaknesses in monitoring and recording actual landings.
- Fishers sometimes misrecord landings, reporting fish caught in a closed fishing area as having been caught in an open area.
- Bycatch includes species not targeted by fishers or allowed by single species quotas. For example, fishers might catch halibut as a bycatch in a cod fishery. A certain amount of bycatch is allowed by quotas; excess bycatch is often illegally discarded.
- Highgrading involves discarding fish to make room for more valuable fish that bring a better economic return or for which there is a need at the processing plant. For example, weekly summaries of highgrading by several offshore draggers

Exhibit 14.7

Catches in Regulatory Area (outside 200-mile limit controlled by Canada)

Total Allowable Catch

Source: Northwest Atlantic Fisheries Organization



in the 1980s involved dumping hundreds of tons of fish.

In many kinds of fishing, most of the discards are dead when they are thrown back, or die soon afterward.

14.38 These unsustainable fishing practices have an impact on estimates of fish mortality. Discards and unrecorded landings are generally not reflected in scientists' data on removals by the commercial fishery; misrecorded landings distort the accuracy of stock assessments. The extent of this imprecision is not easily quantifiable, in part due to lack of data.

Environmental conditions and 14.39 predator-prev relations. Fisheries and Oceans Canada has indicated that natural mortality may have increased due to predator-prey relations. It emphasized that environmental conditions also contributed to the groundfish collapse in certain areas. This is supported by departmental studies showing the poor physiological condition of the groundfish and other stocks as well as the continued decline of the groundfish stocks after fisheries had been closed. The period of the groundfish decline coincided with Atlantic waters becoming colder. The Department believes that colder waters had a negative impact on groundfish stocks, and has conducted research on this topic. The period of groundfish decline also saw substantial continued growth in seal populations as the government restricted the fur trade in response to international pressure. Seals consume groundfish as well as capelin, a groundfish food source. The Department has also conducted research on this topic. While ongoing research focusses on partitioning the causes of the collapse of northern cod, there has been no overall departmental statement on the relative extent to which the collapse of groundfish stocks can be attributed to the respective factors.

14.40 Fisheries and Oceans Canada should pursue the identification of the most likely relative contribution of the various factors related to the collapse of groundfish stocks and provide assurance to Parliament that initiatives to deal with this problem address the most probable causes.

Department's response: In recent years, the Department's scientists have undertaken, in collaboration with scientists from various universities, a number of research projects under the Department's Strategic Research Priority Fund to evaluate the relative contribution of various factors in the collapse of groundfish stocks. A scientific workshop to review the results of these projects is planned for March 1998.

Overcapacity — A Fundamental and Long-standing Problem

14.41 The Atlantic groundfish fishery has a history of recurring crises (Exhibit 14.8). Problems with overcapacity, low incomes and low profit levels are long-standing. Until the 1960s, access to Atlantic fisheries was open and there were few limits on catch levels. The fisheries were characterized by excessive investment, low incomes to fishermen, low returns on investment and depleted stocks.

14.42 According to a now-public 1970 Cabinet memorandum, the Canadian fishing industry even then had an overcapacity both in people and equipment. It was overcapitalized by a ratio of more than 2:1, and it was estimated that Canada's commercial catch in 1970 could be harvested by 40 percent of the boats, half as much gear and half the number of fishers.

14.43 At that time, the federal government realized that a deliberate policy of rationalizing the fishery would

The period of the groundfish decline coincided with Atlantic waters becoming colder and substantial growth in seal populations.

Exhibit 14.8

The Atlantic Groundfish Fishery: A Chronology

1950s and 1960s Post-war expansion	 Government policy fosters programs that support development of fisheries Growing markets for fish in North America New technology for navigating and fish finding, better engines, bigger boats Foreign fishing builds up
1967–1969	 Weaker markets for groundfish, high inventories, declining prices Scarcity of some species, catch per unit of effort declining
1970–1973	 Economic Policy for the Fisheries intended to maximize employment in commercial fishery Landings still declining; demand and prices increasing Landed value increases despite lower landings International Commission for the Northwest Atlantic Fisheries introduced total allowable catches and national allocations in 1972
1974–1976	 Catch rates still declining, unit costs increasing Oil crisis significantly increases fuel costs Market prices dropping Policy for Canada's Commercial Fisheries published in 1976 places people before fish
1977 (att for full 1877)	 Canadian fisheries jurisdiction extended to 200 miles First Canadian Groundfish Fishing Plan allocates stocks among sectors of the fleet
1977–1979	 Federal and provincial expenditures in support of fishery increase Harvesting and processing capacity expands Entry into virtually all fisheries limited Resource shows signs of recovering, market conditions improving but operating losses continue
1981 (1981) (1981)	• Policy for Canada's Atlantic Fisheries in the 1980s emphasizes competitiveness, efficiency and extracting more value from resource, rather than expansionist development philosophy of the 1970s
1981–1983 Financial Crisis	 High interest rates and high debts related to expansion High inventories and poor markets, Canadian dollar appreciates, exports uncompetitive
1983–1984 Restructuring the Atlantic Groundfish Industry	 Report of the Task Force on the Atlantic Fisheries (Kirby) concluded that the fishing industry had "a grossly inadequate equity base" caused by debt-financed overexpansion after the extension of the 200-mile limit. This led to the restructuring of the major offshore companies After extensive negotiations with Newfoundland and Nova Scotia, agreement was reached to create two large, integrated companies with an infusion of government and private sector equity
1985–1988 The Glory Years	 Groundfish stocks recover from 1977 Price of cod blocks doubled More investment in modernizing and rebuilding fleets and plants
1989–1992 Crisis Again	 High fishing pressure (well above target levels), catch rates decline Scientists revise their estimates of northern cod stocks In March 1990, the Independent Review Panel on Northern Cod (Harris) recommends substantially lower total allowable catch Large companies experience major losses, close plants and consolidate operations Atlantic Fisheries Adjustment Program announced in May 1990

1992–1993 Deepening Crisis	 In July 1992, Minister announced two-year moratorium on northern cod Northern Cod Adjustment and Recovery Program (NCARP) to provide income support and support for adjustment out of the fishery Northern cod stocks continue to decline despite moratorium, other groundfish stocks show signs of collapse Fisheries Resource Conservation Council provides advice to the Minister on conservation issues, appropriate catch levels Report of the Task Force on Incomes and Adjustment in the Atlantic Fishery (Cashin) recommends measures to deal with overcapacity, overdependence
1994–1997	 In May 1994, The Atlantic Groundfish Strategy replaces Northern Cod Adjustment and Recovery Program and Atlantic Groundfish Adjustment Program to address adjustment and overcapacity Fishery of the future announced as basis for restructuring the fishing industry in 1996–97 Estimates, Part III; conservation is top priority; capacity rationalization; professionalization, multi-licensing and partnerships

Exhibit 14.8

(cont'd)

create challenges, including the relocation of tens of thousands of people, the sale of thousands of vessels and the phasing out of hundreds of small communities. Because alternative employment was generally unavailable locally, many families would have to be moved and retrained. The government decided that rationalization of the fishery would proceed only as quickly as acceptable alternatives became available. In fact, instead of rationalization the next decade saw expansion.

14.44 The extension of fisheries jurisdiction to 200 miles in January 1977 gave Canada control over the fishery resources off the east and west coasts. Foreign fishing was reduced within the Canadian zone and the allocations available to domestic fleets were increased. Canadian industry reacted by increasing its capacity by investing in larger, more powerful boats with greater technological capabilities. For example, gross registered tonnage increased by 150 percent between 1980 and 1989 (Exhibit 14.9). Competition in the fishery meant that a fisher had to have greater and greater capacity to guarantee a share of

the groundfish resource. With larger boats came higher debts.

14.45 In the early 1980s, the major firms found themselves in debt and on the verge of collapse, given their rapid expansion of capacity; their debt-to-equity ratio was 9:1. The economic recession, coupled with high interest rates and low prices, caused a financial crisis in the industry. Largely through government intervention, the industry was refinanced and restructured. Overcapitalization and high debts can lead to unsustainable harvesting practices aimed at maximizing the fishers' return on their effort.

14.46 Many people were attracted to the small boat inshore fishery by the easy access granted under past licensing policies and by the lure of government support programs that augmented their limited income from fishing. The period from 1980 to 1991 saw a growth of 31 percent in the number of individuals employed in Atlantic fish processing jobs; during the same period, the available fishery resource declined by 2.5 percent. The discrepancy was particularly notable in Newfoundland, where the number of

Canadian industry increased capacity by investing in larger, more powerful boats with greater technological capabilities.

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people in the fish processing sector increased by 50 percent while the available fish stocks declined by 18 percent (Exhibit 14.10). As the resource declined, dependence on the support programs increased; in certain sectors of the fishery there was a total reliance on support because of the complete collapse of the resource.

14.47 The Minister appointed The Scotia-Fundy Groundfish Task Force (Haché) in July 1989, in response to groundfish quota reductions on the Scotian Shelf. The Task Force reported that haddock stocks had been exploited at two to four times the target levels since 1984. The Report concluded that excessive harvesting capacity was a major obstacle to a turnaround in the fishery, and that overcapacity and overinvestment had to be reduced as quickly as possible.

14.48 Given the increasing catch failures in the Atlantic groundfish industry, and other long-standing structural problems of the industry, in 1993 the ministers of Fisheries and Oceans and Human Resources Development established the Task Force on Incomes and Adjustment in the

Atlantic Fishery. That Task Force also identified overcapacity as a fundamental problem of the groundfish industry.

14.49 It has been widely recognized that the Atlantic fishery has been estimated to have approximately double the capacity needed. This overcapacity contributes to overfishing because fishermen have substantial investments in vessels and fishing gear, and thus have a desire to maximize their return in a competitive fishing environment.

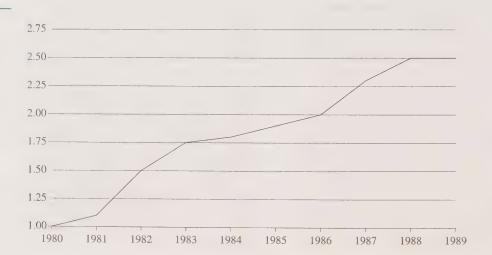
Socio-economic policies contribute to overcapacity

Even in more prosperous times, income from the Atlantic fisheries was low. As shown in Exhibit 14.5, net annual earnings from fishing for Atlantic fishers averaged \$8,100 in 1990; with additional work and transfer payments, total average income rose to \$19,300. A fish plant worker earned on average \$8,200 a year from processing; outside work and transfer payments such as unemployment insurance raised total income to \$15,900. Individuals' unemployment insurance benefits on average almost equalled their net earnings from fishing or processing. In more than half the families involved in the industry, two or more persons made their

Overcapacity contributes to overfishing.

Exhibit 14.9

Gross Registered Tonnage Relative to 1980



Source: Fisheries and Oceans Canada

income through a combination of part-time fishery work and unemployment insurance.

- 14.51 Unemployment insurance and other initiatives to relieve the socio-economic problems of those in the Atlantic fisheries contributed to overcapacity, since fishery employment even for short periods qualified individuals for unemployment insurance benefits. For example, the period of employment necessary for unemployment insurance varied with the local fishing season; the length of the fishing seasons varied and could be less than 10 weeks.
- 14.52 Between 1980 and 1991, the number of persons employed in Atlantic fisheries processing increased by a much higher margin than did full-time person-years. This would suggest that by 1991 the average person was working fewer months. The average duration of processing jobs dropped from 8 months in 1980 to 5.5 months in 1991 (Exhibit 14.10).
- **14.53** Federal and provincial governments have contributed to capacity by providing loans and loan guarantees to build boats and improve fishing

technology. For example, federal support for the fishing industry in Canada included funds provided by the Fishing Vessel Assistance Program (until 1986), the Shipbuilding Industry Assistance Program (until 1985) and the Fishing Vessel Insurance Plan (since privatized). Unemployment insurance payments for fishers increased from \$20.4 million in 1972-73 to \$270.1 million in 1988-89. The Province of Newfoundland provided payments called "bounties" for new inshore fishing vessels. Over the years, the reported number of processing plants with federal registration allowing interprovincial and international sales grew from 641 in 1980 to over 900 in 1988 (Exhibit 14.11), and to 1,063 in 1991; the growth in their number does not capture change in the capacities of individual processing plants.

- **14.54** The above-noted fundamental problems in the groundfish industry demonstrate that:
 - groundfish resources are finite;
- the groundfish industry continues to have fundamental overcapacity; and
- even if the groundfish returned to levels seen in the last decade, the groundfish industry could not provide

Unemployment insurance and other initiatives to relieve the socio-economic problems of those in the Atlantic fisheries contributed to overcapacity, since fishery employment for even short periods of time qualified individuals for unemployment insurance benefits.

Exhibit 14.10

Summary of Changes in Fish Processing Employment and Resource Availability - Atlantic Fishery, 1980-1991

	I	erson-Ye	ars	.ř. : L i	ndividual	S	% Change in Resource Availability	Fish Proc	Ouration of cessing Job onths)
	1980	1991	% Change	1980	1991	% Change	1980– 1991	1980	1991
Atlantic	31,240	27,939	(11)	46,809	61,515	31	(2.5)	8	5.5
Newfoundland	13,519	10,900	(19)	20,148	30,199	50	(18)	8	4.3
Nova Scotia	10,234	9,836	(4)	12,841	14,627	14	(12)	9.6	8
Prince Edward Island	860	1,481	72	1,690	2,975	76	28	6	6
New Brunswick	4,210	4,174	. (1)	7,914	10,064	27	6	6.4	5
Quebec	2,417	1,549	(36)	4,218	3,650	(14)	(13)	6.8	5

Source: Task Force on Incomes and Adjustment in the Atlantic Fishery

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The resource base is not, and has not been, by itself, sufficient to support the number of people and coastal communities that have depended on the fishery in recent history.

adequate incomes for the number of people historically dependent on it.

14.55 The collapse has provided an opportunity to address these fundamental problems. Without fish, the fishery is no longer a basis for governments to provide income support. The solution requires that the government deal with overcapacity and dependence on the groundfishery.

14.56 The capacity of the groundfish harvesting industry is a term that is not easily defined, and on which there is little agreement. The government has focussed on the number of licence holders or the number of people the industry can employ. While these are important components of harvesting capacity, the risk of overfishing due to the ability and need of the industry to catch fish is also a component. This brings in the concepts of capital investment in technology, major improvements in the ability of improved technologies to catch fish and desired levels of income for those participating in the industry.

14.57 Progress has been made in reducing the number of groundfish licences from over 17,000 in 1993 to just

over 10,000 "core" licences in 1997 (Chapter 15, Exhibit 15.5). Nevertheless, excess harvesting capacity in terms of an ability to kill fish remains.

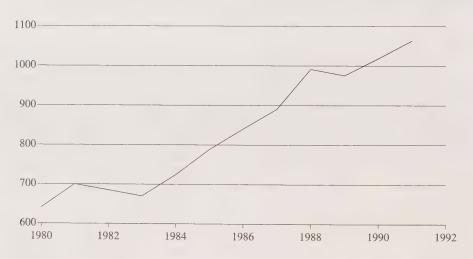
14.58 Fisheries and Oceans Canada should develop and propose a strategy to government to further reduce overcapacity in the groundfish industry.

Department's response: While significant reduction has been achieved, excess groundfish harvesting capacity remains. Had the budget for rationalization been maintained at \$300 million, a larger number of licences would have been retired under The Atlantic Groundfish Strategy. The Department will propose a strategy to achieve further capacity reduction, over time, taking into account the funding available and the prospects regarding alternative economic opportunities for affected fishers.

14.59 Income support issues must be dealt with in their own right. The resource base is not, and has not been, by itself, sufficient to support the number of people and coastal communities that have depended on the fishery in recent history. It must be recognized that managing the fishery on a sustainable development basis would clearly require finding a solution to

Exhibit 14.11

Number of Registered Fish Processing Plants in Atlantic Canada



Source: Fisheries and Oceans Canada

Change in number of registered facilities affected by changes in comprehensiveness of licensing policy. After 1992, plants were required to register annually.

the unemployment of people who are no longer part of the fishery. In other words, if the fishery is to be managed on a sustainable development basis, ecologically and economically, then another means of addressing the social and cultural issues of coastal communities has to be found.

14.60 To ensure that the fishery is managed on a sustainable development basis, the government should address the social and cultural issues of coastal communities.

Department's response: The Department's objective of conservation is intended to ensure a sustainable fisheries resource that is capable of providing sustainable incomes for harvesters. The Department agrees that the groundfish resource will not be able to provide adequate incomes for the number of people historically dependent on it. Achievement of the Department's objective for a sustainable fishery would be facilitated by the availability of viable alternatives for affected fishers who can no longer rely upon the fishery for their livelihood.

Federal Government Response to the Groundfish Collapse

14.61 The federal government's response to the progressive decline of Atlantic Canada's groundfish stocks included a series of studies, a variety of income support and adjustment programs, fisheries renewal initiatives and changes to fisheries management practices.

Income support and adjustment programs

14.62 Income support and adjustment initiatives to help Atlantic Canada cope with the groundfish decline and collapse have ranged from programs designed to cover localized catch failures in the late 1980s to the larger, more comprehensive

programs of the 1990s. These later programs include the Atlantic Fisheries Adjustment Program, the Northern Cod Adjustment and Recovery Program, the Atlantic Groundfish Adjustment Program with its related initiatives and The Atlantic Groundfish Strategy (Exhibit 14.12).

14.63 In 1993, the Office of the Auditor General reported on the Northern Cod Adjustment and Recovery Program, which provided income support and adjustment to those affected by the decline of the northern cod between 1992 and 1994. Chapters 15 and 16 of this Report address the implementation of The Atlantic Groundfish Strategy.

Fisheries Management Framework

14.64 The Constitution Act (formerly the British North America Act) provides for the federal Parliament's jurisdiction over seacoast and inland fisheries. The Act provides the legal basis for the federal government to enact legislation dealing with marine and fisheries services. Fisheries and Oceans Canada carries out the federal government's responsibilities for fisheries management under the Fisheries Act and other pieces of legislation.

14.65 One of the challenges in setting up an enduring framework for management of the Canadian fisheries is dealing with jurisdictional responsibility. While the federal government has responsibility for fish harvesting, provincial governments are responsible for registering fish processing plants for operation. The interests of the two levels of government may not always coincide.

14.66 Another challenge is ensuring that there is a common understanding of "a sustainable resource base" and "sustainable development". "A sustainable resource base" involves conservation of

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the resources for harvesting purposes. "Sustainable development" includes additional considerations such as social and economic impacts.

14.67 Fisheries resources are used for Aboriginal food, social and ceremonial purposes as well as commercial and recreational purposes. Fisheries and Oceans Canada manages many groundfish

stocks in Atlantic Canada. In consultation with clients, it sets total allowable catch limits on these stocks for each fishing zone on the basis of scientific advice developed on each stock's individual dynamics. (Stock dynamics include rates of growth, reproduction and mortality.)

14.68 We assessed whether Atlantic groundfish are managed within a

Exhibit 14.12

Groundfish Programs

Program	Atlantic Fisheries Adjustment Program/ Quebec Federal Fisheries Development Program (1990–1995)	The Northern Cod Adjustment and Recovery Program (1992–1994)	The Atlantic Groundfish Adjustment Program and Related Programs (1993–1994)	The Atlantic Groundfish Strategy (1994–1998)
Resources*	\$637 million	\$587 million	\$381 million	\$1.9 billion
Objectives	 rebuild the fish stocks adjust to current realities economic diversification 	respond to the immediate income needs of fishermen and plant workers more economically viable and environmentally sustainable northern cod fishery	 enhance employment opportunities upgrade and develop new skills assist those most in need 	renew the resource and reduce harvesting and processing capacity facilitate labour adjustment enhance profession of fishers facilitate community economic development
Implementation	Fisheries and Oceans Canada, Employment and Immigration Canada, Labour Canada, Atlantic Canada Opportunities Agency, Federal Office of Regional Development – Quebec, others	Fisheries and Oceans Canada, Employment and Immigration Canada	Fisheries and Oceans Canada, Human Resources Development Canada, Atlantic Canada Opportunities Agency	Fisheries and Oceans Canada, Human Resources Development Canada, Atlantic Canada Opportunities Agency, Federal Office of Regional Development – Quebec
Elements	 new inputs to stock assessment community-based projects as alternatives to the reduced groundfish fishery direct payments to fishers and plant workers economic assistance 	income support assistance to adjust out of the fishery in the form of training, early retirement out of the fishery licence retirement vessel support to assist owners to maintain vessels and gear during the moratorium	income supplement for vessel owners plant worker adjustment vessel support community development fisheries alternative sector partnerships training job development transitional fisheries adjustment fisheries closing training allowance	income support adjustment industry rationalization long-term community economic development

^{*} Main Estimates

framework of management accountability for sustainable fisheries that responds both to the government's objectives and to the Department's mandate and long-term objectives. We found that the fisheries management framework requires clarification. Fisheries management decisions appear to relate directly or indirectly to a number of different federal government policy objectives. The Department has stated that its mandate is conservation, but other related government objectives include providing economic opportunity, facilitating access to reasonable income and Canadianization of the fishery.

National fisheries policy needs to be developed

It is important that fisheries be managed consistent with a policy of sustaining the fisheries resource base — a policy that would place primary importance on conserving the resource; healthy fisheries would then contribute to achieving and maintaining social and economic objectives, including the viability of coastal communities. Under the Green Plan, the federal government was to develop a national fisheries policy as part of a strategy to ensure the long-term sustainability of fishery resources. Although background papers have been prepared, a national fisheries policy and an action plan have yet to be developed.

14.70 Statements of Canadian commercial fishing policy were advanced in 1970 and 1976. In 1970 the main objective of government fisheries policy was to maximize employment in Canada's commercial fishery. The 1976 Policy of Canada's Commercial Fisheries indicated that in the future fisheries would be regulated in the interest of people. In 1981 the Minister of Fisheries and Oceans

published a discussion paper on Canada's Atlantic fisheries policy for the 1980s. This document included as a strategic objective "to maintain fishery resources at levels which will generate the maximum continuing economic and social benefits." The current status of these policy documents is unclear.

- 14.71 Legislation passed in the 1980s established the objectives of economic viability and maximized employment. The *Atlantic Fisheries Restructuring Act* adopted as a hierarchical set of policy objectives for the Atlantic fisheries:
- that the Atlantic fishing industry be economically viable on an ongoing basis;
- that employment in the Atlantic fishing industry be maximized, subject to the constraint that those employed receive a reasonable income; and
- that fish on the Atlantic Coast of Canada be harvested and processed by Canadians to the extent that this objective is consistent with the first two objectives and with Canada's international treaty obligations.

While the importance of conservation may have been understood, there was no explicit reference to it in this legislation.

14.72 The Fisheries Act provides for regulations to conserve and protect fish. The Fisheries Act was amended in 1985 to include a purpose statement providing for the conservation and protection of fish by means of proper management, and for allocation and control of Canada's seacoast fisheries in order to provide fishers and others with economic and social benefits from the use of fish. However, that purpose statement was repealed in 1987.

14.73 The federal government tabled two new fisheries bills to replace the current *Fisheries Act*, the most recent of which advanced the precautionary

Fisheries management decisions appear to relate directly or indirectly to a number of different federal government policy objectives.

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approach to fisheries resource management; neither bill became law. The second bill was tabled in 1996 and had not become law when the 1997 federal election was called.

specifies that the Minister of Fisheries and Oceans shall lead and facilitate the development and implementation of a national strategy for the management of estuarine, coastal and marine ecosystems in Canadian waters based on the principles of sustainable development, integrated management and the precautionary approach. The legislation defines the precautionary approach as "erring on the side of caution."

14.75 While the precautionary approach is inherent in the principles of the United Nations Straddling Stocks agreement (Exhibit 14.13), Canada has not yet ratified this agreement or, likewise, the 1982 Law of the Sea Convention. However, Canada was an active participant in the United Nations

Conference on the Environment and Development in 1992 in Rio de Janeiro, Brazil, which advanced the precautionary approach. Canadian scientists are working with scientists from other countries to advance the concept of the precautionary approach.

14.76 Fisheries and Oceans Canada should renew its efforts to have the government clarify fisheries objectives in legislation and develop a national fisheries policy framework.

Department's response: The Department agrees that it would be useful to affirm its objectives in legislation and establish a consolidated national policy framework. In this regard, the bill amending the Fisheries Act that was before the House when the election was called described the purpose of the Act as establishing powers, duties and functions to be exercised to conserve and manage fisheries in the interest of the present and future generations. It endorsed the precautionary principle, and affirmed that conservation of Canada's fisheries and their management on a sustainable basis are

Exhibit 14.13

The 1995 Conference on Straddling Fish Stocks and Highly Migratory Fish Stocks

General Principles	 Ensure long-term sustainability, promote optimum utilization Use best scientific evidence (including environmental) Assess impacts of fishing on target stocks and non-target species Maintain populations above "levels at which their reproduction may become seriously threatened" Minimize pollution, discards, catch by lost gear, catch on non-target species, etc. Protect biodiversity Prevent overfishing and excess fishing capacity Collect and share data on catches and fishing activities Conduct scientific research and develop technologies for conservation
"Precautionary Approach" to the Management of Fisheries	 Protect living marine resources and to preserve the marine environment Be more cautious when information is uncertain Improve decision making by sharing best scientific information and adopting ways to deal with risk and uncertainty Adopt stock-specific reference points Take into account uncertainties (all types), as well as impact on non-target species Ensure that reference points are not exceeded – emergency action may be needed

central to the economic viability of harvesters and processors and the well-being of communities dependent on fisheries resources.

Departmental policy requires clarification

14.77 We found that the Department has set out policy statements in a number of documents; however, there is no integrated, documented sustainable fisheries policy. The Department recognizes this situation and plans to return to Cabinet in the autumn of 1997 to reconfirm its strategy of fishery management reform and to see that the strategy is reflected in a public policy document on fisheries management. The Department is also working on a sustainable development strategy and action plan as required by the recent revisions to the Auditor General Act.

Fisheries and Oceans Canada has developed principles to guide fishing industry restructuring and fisheries management renewal that have evolved over time. The first of these principles places a priority on conservation. However, it is not clear how the priority on conservation relates to other objectives for the Atlantic fisheries currently defined in law: economic viability, employment maximization and Canadianization of the fishery (see paragraph 14.70). It is also unclear how the priority on conservation relates to other considerations that have an impact on sustainable development, such as use of the fishery of the future as a means of accessing income support, assuring the long-term viability of coastal communities and maintaining population in remote parts of Canada.

14.79 Fisheries and Oceans Canada and other stakeholders have made progress with respect to the restructuring principles of professionalization of the fishery,

multi-species licences and partnership. However, we were unable to find elaboration on two primary restructuring principles, "conservation is the paramount priority" and "capacity must balance with available resources". For example, what does it mean to say that conservation is the paramount priority? What is capacity? At what point does capacity meet the available fishery resource? And when it does, what becomes of excess fishing and processing capacity?

14.80 Fisheries and Oceans Canada should pursue, as a priority, completion of a consolidated policy framework related to sustaining the fisheries resource base.

Department's response: The Department agrees that a consolidated policy framework would be useful in guiding the implementation of the Department's conservation objective in ensuring the sustainability of the fishery resource. A framework will be prepared to elaborate on the policy objectives and principles that have been adopted by the Department and that are referred to in paragraphs 14.97, 14.98, 15.10, 15.11 and 15.12.

Need to integrate planning and performance reporting

14.81 We reviewed the Department's planning and reporting documents supporting the government's planning, reporting and accountability structure. The Department has been implementing this structure at the same time as it is carrying out severe resource reductions resulting from Program Review, and integrating Coast Guard and fisheries components of the Department.

14.82 We found that performance expectations were not defined precisely enough for Parliament to know when results have been achieved. The indicators of accomplishment provided were frequently actions that the Department

Performance
expectations were not
defined precisely
enough for Parliament
to know when results
have been achieved.

intended to take. The Department has not yet developed measurable indicators related to its key guiding principles.

14.83 Fisheries and Oceans has recognized the need to develop performance indicators and an initiative is under way in this regard. Furthermore, for fisheries management, the Department is in the process of developing an approach to business line performance measures related to the conservation of fish stocks, co-management of the fishery and industry capacity.

14.84 The Department uses an accountability accord in fisheries management to set out goals, deliverables, responsibilities and, on occasion, time frames. Progress on this accord between senior management and the Deputy Minister is reported every six months.

14.85 The Department had a fisheries management business plan for 1996–97 that included:

- one business line objective;
- the six priorities of the Minister of Fisheries and Oceans (October 1995);
- seven target areas for fisheries management;
- a subordinate priority or set of priorities within each of the seven target areas (total of 32 subordinate priorities); and
- subordinate targets for each of the priorities within each target area.

14.86 Many of these targets in the fisheries management business plan consisted of actions to be taken; some had delivery dates. The business plan did not identify who was to deliver the expected performance against each target, and periodic reports against targets were not produced. We also found that it was not clear from the business plan how the

Minister's primary guiding principles were to be addressed.

14.87 We found limited use of business plans and performance reports at operational levels of the Department. A strategic planning framework has been developed for fisheries management but a strategic plan has yet to be developed.

14.88 The two headquarters organizations most directly involved in national co-ordination of fisheries management activities did not have business plans; such plans could improve the linkage between overall departmental direction and those who implement and enforce management plans for specific fisheries. There is a strategic plan for the national enforcement organization but not for the national fisheries resource management organization.

14.89 Fisheries and Oceans Canada should establish measurable indicators and performance expectations to assess progress in applying guiding principles and integrate those indicators in its planning, reporting and accountability process that responds to the government model.

Department's response: The Department agrees and will continue the development of performance measures and business plans in line with government guidelines and standards.

Conclusion

14.90 Managing the Atlantic groundfish industry on a sustainable basis is an extremely challenging goal. Studies of the fisheries' problems have indicated that the majority of people attached to the fishing industry continue to believe that they have a right to fish, or that, should the fishery fail, they are entitled to income support. Because fishing incomes are generally low and seasonal, fishers have regularly relied

on employment insurance benefits to provide additional income.

The problems in the fishery are very complex and the common property nature of the resource adds to this complexity. It is not just a case of managing the resource with consideration of ecological and economic sustainability; it also involves considering the social and cultural implications of these decisions. While key groundfish resource allocation and related management decisions are the legislative responsibility of the Minister of Fisheries and Oceans, a solution to the fundamental problems of the fishery involves several departments of the federal government and, indeed, other governments and external parties. Thus, fisheries resource allocation and management decisions have a political dimension.

14.92 Currently, the incentive is for fishers to remain attached to the fishery rather than to leave it. In fact, those involved in the industry may see an advantage to strengthening the attachment where possible, since federal income support or employment insurance benefits remain attractive compared with other social support programs, and few employment alternatives exist. It appears

that provincial governments and other organizations may have little reason to encourage people to leave the fishery; in the absence of employment alternatives, the demand on provincial social programs could increase.

14.93 As we have noted in this chapter, a national fisheries policy is lacking. Principles have been stated, but measurable indicators to guide and assess progress need to be developed. The Department needs to integrate these principles in its planning and performance reporting processes. As Chapter 15 points out, while progress has been made toward achieving the principle of matching capacity to the resource base, much more effort is required to reduce harvesting capacity.

14.94 We also note that high numbers of people still rely on the fishery and on associated income support. In the past, this created a demand that could not be sustained by the capacity of the resource base and there is no reason to expect that this will change in the future. The movement of funding for The Atlantic Groundfish Strategy from the adjustment and rationalization components of the program to the income support component served to encourage people to remain

It is not just a case of managing the resource with consideration of ecological and economic sustainability.





Fishing communities offer few alternative employment opportunities (see paragraph 14.92).

Fisheries and Oceans Canada – Sustainable Fisheries Framework: Atlantic Groundfish

Another means of addressing the social and cultural issues of coastal communities has to be found.

attached to the fishery and dependent on federal government support. The original objective of a 50 percent reduction in capacity established under The Atlantic Groundfish Strategy will certainly not be achieved by the anticipated end of the Strategy in 1998.

14.95 After spending over \$3 billion of new and reallocated funds to support the industry, including \$1.9 billion under The Atlantic Groundfish Strategy, the problems in the groundfish fishery remain. The fisheries management practices need to be further improved to ensure the sustainability of the resource base; dependency continues on the fishery to provide access to federal income support programs; and few employment alternatives exist for people in coastal communities. The problem is compounded by the fact that the majority of the people in these communities have education levels that limit alternative choices of employment.

14.96 In summary, our main audit findings are:

- a national fisheries policy has not yet been put in place;
- further progress is required in dealing with the fundamental problems in the fishery, especially matching capacity to the resource base (see Chapter 15);
- an adequate accountability framework was not established for The Atlantic Groundfish Strategy (see Chapter 16); and
- income support, adjustment and rationalization of capacity provided by programs have not contributed significantly to fisheries objectives or to those of The Atlantic Groundfish Strategy (see Chapters 15 and 16).

The reduced funding provided for labour adjustment and rationalization of capacity resulted in failure to achieve the fisheries objectives of The Atlantic Groundfish Strategy.

14.97 We believe that the government needs to deal with overcapacity. However, we recognize that while the Minister of Fisheries and Oceans has the power to reduce capacity and conserve fish, and the Department has taken a number of initiatives, the Minister and Department cannot solve the sustainable development problem associated with the fishery by themselves. The resource base is not, and has not been, by itself, sufficient to support the number of people and coastal communities that have depended on the fishery in recent decades. It must be recognized that managing the fishery on a sustainable development basis would clearly demonstrate the need to find a solution to the unemployment of people who are no longer part of the fishery. In other words, if the fishery is to be managed on a sustainable development basis, in an ecological and economical manner that reflects stated intentions, then another means of addressing the social and cultural issues of coastal communities has to be found.

14.98 This concern requires urgent attention. It is reasonable to expect that there will be pressure for further income support after the end of funding under The Atlantic Groundfish Strategy, since overcapacity remains and there is little indication that the fish are returning in sufficient numbers to allow the levels of fishing that existed before the moratoria. Even if the groundfish stocks were to return to historical levels, dependency on government income support would continue in some form unless there were to be a substantial reduction of participation in the fishery. The level of income the fishery can provide is limited.

14.99 We are concerned that if further funding is provided primarily for income

Fisheries and Oceans Canada – Sustainable Fisheries Framework: Atlantic Groundfish

support, the excess capacity in the industry will still not be addressed. The previous programs have not worked, and there is no reason to believe that this approach will be any more successful if

applied again in the future. The impact of not addressing the well-documented fundamental problems of the fishery has been clearly demonstrated in the Atlantic groundfish industry.



About the Audit

Scope

Chapter 14 sets out the historic, biological, economic and social context in which the Fisheries and Oceans Canada manages groundfish resources, reviews identified causes of the current crisis and examines the federal government response. The chapter describes the roles of Fisheries and Oceans Canada and Human Resources Development Canada in The Atlantic Groundfish Strategy. It also examines whether the principles of the fishery of the future as advanced by Fisheries and Oceans Canada provide a sustainable management framework as they apply to the groundfish industry.

Chapter 15 reports on the implementation of these principles, steps taken to match fishing capacity to the fishery resource and progress toward establishing partnerships with industry. It assesses the extent to which changes to fisheries management practices deal with the fundamental problems in the fishery.

Chapter 16 assesses the degree to which the adjustment components of The Atlantic Groundfish Strategy administered by Human Resources Development Canada and Fisheries and Oceans Canada have adjusted fishers and processors out of the groundfish industry.

Objectives

We carried out our audit to determine:

- whether Atlantic groundfish fisheries are managed within a sustainable framework (Chapter 14);
- whether fisheries management practices for the Atlantic groundfish fishery have resulted in progress in dealing with the fundamental problems in the fishery (Chapter 15);
- whether an effective accountability framework for The Atlantic Groundfish Strategy has been established (Chapter 16); and
- the extent to which the income support, capacity rationalization and adjustment programs administered by Human Resources Development Canada and Fisheries and Oceans Canada have contributed to the achievement of fisheries management objectives and The Atlantic Groundfish Strategy objectives (Chapters 15 and 16).

Criteria (Chapter 14)

We would expect that the Atlantic groundfish management framework and the framework for The Atlantic Groundfish Strategy would adequately respond to government policy objectives as well as the Fisheries and Oceans mandate and long-term objectives.

We would expect that appropriate implementation strategies and performance expectations for groundfish fishery management objectives would be developed based on adequate information and analysis, to deal with the fundamental problems of the fishery.

We would expect that Fisheries and Oceans would periodically report on the extent to which fisheries management objectives and The Atlantic Groundfish Strategy objectives have been achieved.

Criteria for Chapters 15 and 16 are found in those chapters.

Fisheries and Oceans Canada – Sustainable Fisheries Framework: Atlantic Groundfish

Audit Team

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Chapter 15

Fisheries and Oceans Canada — Rationalization and Renewal: Atlantic Groundfish

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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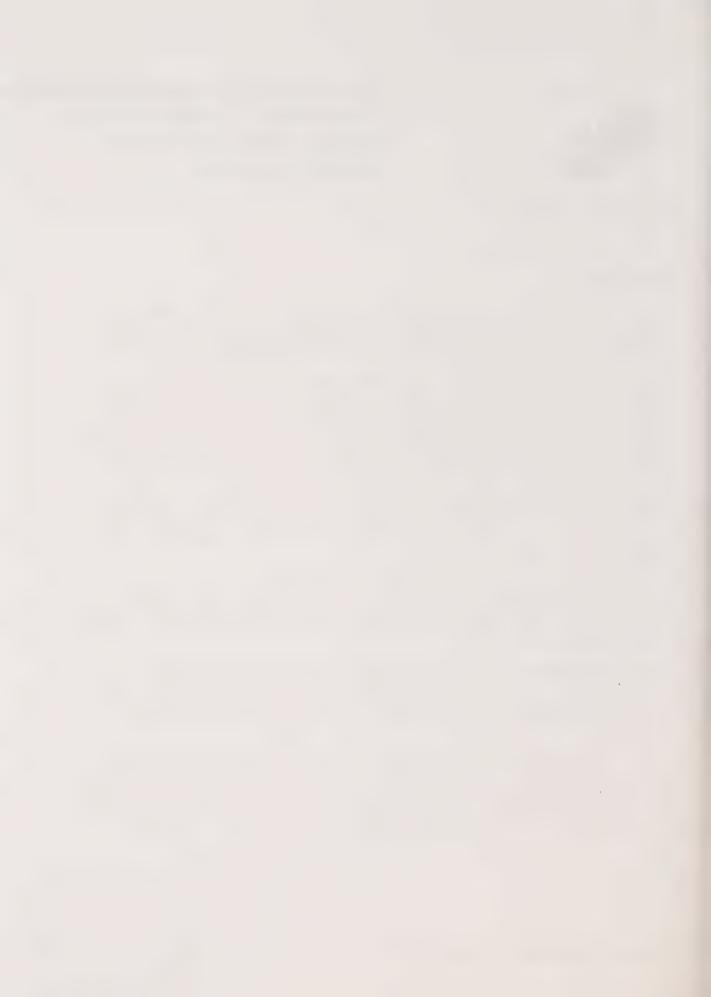


Assistant Auditor General: Don Young Responsible Auditor: Doug Timmins

Fisheries and Oceans Canada — Rationalization and Renewal: Atlantic Groundfish

Main Points

- 15.1 The Department has identified the need for fundamental changes in the fishery, in its relationship with the industry and in its management practices, in order to achieve a sustainable fishery. Since 1992, the Department has moved to reduce the number of groundfish licences, made changes in the management of the fishery and is developing new arrangements for the sharing of responsibility for managing the fishery in the future.
- 15.2 A key objective of The Atlantic Groundfish Strategy (TAGS) and other initiatives is to reduce existing harvesting capacity by at least 50 percent over the long term. The allocation of funds to reduce harvesting capacity under TAGS, originally \$300 million, was subsequently reduced to \$97 million. The Department focussed its capacity reduction efforts on the removal of licences and is paying about \$88 million of this amount to fishers to retire 545 groundfish licences and 266 fishers without licences. The Department would have been able to reduce more licences had the funds allocated to licence buyback and retirement not been reduced by almost \$200 million. A further 2,626 licences have been identified for eventual removal from the fishery once the current licence holders exit the fishery. Assuming that the Department is able to effect the removal of these licences, it will have removed approximately 23 percent of the groundfish licences in place at the time TAGS was introduced. However, this will still leave about 10,000 groundfish licences, a portion of which represents the groundfish harvesters who historically caught most of the fish. Thus, significant overcapacity, in terms of the ability to catch fish, will remain.
- 15.3 The Department has made many changes to its groundfish management activities since 1992, which it believes represent improvements over practices that were previously in place. These changes include the introduction of conservation measures in conservation harvesting plans and the integration of fisher knowledge in groundfish management. Nonetheless, fisheries management practices need to be further improved to ensure the sustainability of the resource base.
- 15.4 Past management practices were introduced with the intention of ensuring conservation. For a variety of reasons, these practices were not successful when implemented. To deal with the inherent uncertainty of the resource base, a precautionary approach is required as a basis for decisions. In addition, further improvements are necessary in catch monitoring, and enforcement must become a more important and active component of groundfish management.
- 15.5 While implementing Program Review cutbacks, the Department is also reorganizing. Its long-term strategy is to transfer more fisheries management responsibilities to the groundfish industry. The transfer has not yet occurred, in part because of legislative limitations but also due to the inability of some segments of the industry to accept greater responsibility. In the absence of assurance that industry can and will accept increased responsibility, we are concerned about the potential impacts on conservation as a result of reductions and planned changes to the Department's groundfish management activities.



Introduction

Crises are not new to the groundfish industry

- 15.6 The Atlantic groundfish industry has a history of critical problems, some of them social and economic. In the 1990s, the collapse of the stocks added to the existing social and economic factors, heightening the crisis.
- Chapter 14 sets out the historic, biological, economic and social context in which the Department manages groundfish resources. It reviews some causes of the current crisis, describes the federal government's response, and thereby establishes a context that is important to a complete understanding of the issues raised in this chapter. Chapter 16 focusses on The Atlantic Groundfish Strategy (TAGS) and examines the labour adjustment component, for which Human Resources Development Canada is responsible, and the accountability framework of the Strategy.

Government initiatives to rationalize the industry and renew fisheries management

- 15.8 Fisheries management has been under great stress since the groundfish stocks began to decline in the late 1980s. By 1993, the full extent of the decline had become clear to the government.
- 15.9 In April 1994, the government established The Atlantic Groundfish Strategy as a response to the groundfish crisis. The Strategy provided for income support to fishers and plantworkers affected by the collapse of the groundfish stocks, as well as adjustment to employment outside of the fishery, reduction of industry capacity and renewal of the industry.

- 15.10 The 1994 Program Review exercise required government departments to rethink the rationale for all of their programs. As part of that exercise, Fisheries and Oceans Canada identified its core mandate as "the conservation and sustained utilization of fisheries resources in marine and inland waters."
- 15.11 The Department established a strategic action plan as a result of Program Review, covering all Atlantic fisheries, for implementing industry rationalization and fisheries renewal initiatives. An important factor in developing the strategy was the reduction in resources allocated to fisheries management (including the science function), which the Department has reported will decline by approximately 40 percent by 1999. The strategy for fisheries management focussed on three areas:
- emphasis on the primary mandate, conservation and sustained use of the resource, and withdrawal from activities less relevant to this core business (such as industry support and small craft harbours);
- simplified and more effective program delivery; and
- devolution to fish harvesters of a greater decision-making role and more responsibility for costs of resource conservation and management.
- 15.12 The plan emphasized industry restructuring (changing the fishery and the Department's relationship with the industry) and fisheries management reform (changing the way the Department manages the fishery). The objective was to achieve a fishery that is:
- economically and environmentally sustainable;
- stable and capable of providing adequate levels of income; and
- self-reliant, competitive and viable without subsidization.

The Department recognized that the move to this vision of the fishery of the future would take a longer period of time to institute for the groundfish industry than for other Atlantic fisheries.

Current status of the groundfish stocks

15.13 The number of groundfish stocks that were available for commercial fishing during the 1996 fishing season was very limited. The only significant fishing was off southwest Nova Scotia for cod, haddock, flounder and pollock. In other areas, there was fishing for flounder, redfish and Greenland halibut. The total allowable catch or quota for these fisheries represents only a small percentage of the fishery that existed prior to the moratoria.

15.14 During this audit, the Minister announced that fisheries would be reopened for cod stocks within Northwest Atlantic Fisheries Organization (NAFO) fishing zones off Newfoundland — 3Ps (the south coast) and 3Pn4RS (the northern Gulf of St. Lawrence). These fisheries were reopened at levels below the historical catch rates prior to the moratoria. Groundfish moratoria are still in place for 20 groundfish stocks across Atlantic Canada.

Focus of the audit

15.15 This chapter reports on fisheries management practices for the Atlantic groundfish fishery and the extent to which they have resulted in progress in dealing with historical fundamental problems in the fishery. It also describes the extent to which the capacity rationalization administered by the Department has contributed to the success of both fisheries management and The Atlantic Groundfish Strategy objectives. Details of the historical fundamental problems in the

fishery are identified in Chapter 14, and can be summarized as:

- overcapacity in the harvesting and processing sectors;
- the difficulties in accurately assessing the status of the groundfish stocks on a timely basis, arising from variability in marine environmental factors and sampling variation; and
- fishing at levels that are not sustainable, including the use of unsustainable fishing practices (misreporting, dumping of bycatch, highgrading, etc.).

The processing sector is the responsibility of the provincial governments and therefore was not directly covered by this audit. Overcapacity in the processing sector puts pressure on the federal government to ensure that sufficient fish are available to operate the plants. The management of groundfish stocks that are within the NAFO jurisdiction was not covered by this audit.

15.16 We examined selected key initiatives that the Department has taken to address these problems. In particular, we audited the capacity reduction initiatives designed to reduce excess harvesting capacity; the informationgathering initiatives designed to improve the assessment and management of stocks: enforcement initiatives designed to address unsustainable fishing practices; and initiatives designed to provide more control and responsibility to fishers. There are some government initiatives that could have an impact on the rationalization and renewal of the Atlantic groundfish industry but that were not within the scope of this audit, although they may be referred to in the chapter. Exhibit 15.1 displays rationalization and renewal initiatives, highlighting those that were included in the audit. With the exception of the TAGS programs, these initiatives

apply to more than just the groundfish industry.

15.17 Further details are presented in **About the Audit** at the end of the chapter.

Observations and Recommendations

Industry Rationalization

Previous attempts to reduce capacity

15.18 The collapse of the northern cod stock, which led to the moratorium in 1992, focussed the government's attention on the problem of overcapacity in the fishery. As part of the Northern Cod Adjustment and Recovery Program (NCARP), the government set out to reduce the capacity in the groundfish harvesting sector through removal of groundfish licences. It was able to retire 876 groundfish licences at a cost of \$24.8 million, but recognized that overcapacity still existed. Chapter 15 of our 1993 Report noted that the Department had achieved lower than

expected reductions in the number of licence holders.

15.19 In 1992, the Minister "froze" 5,346 inactive groundfish licences. After appeals and the review of The Atlantic Groundfish Strategy Special Eligibility Criteria, 1,981 groundfish licences were eventually eliminated.

The Atlantic Groundfish Strategy continues response to groundfish crisis

Subsequent to 1992, the crisis in the groundfish fishery spread beyond northern cod to almost all of the other groundfish stocks. The government responded to this growing crisis with the announcement of The Atlantic Groundfish Strategy (TAGS) on 14 April 1994. TAGS was a multi-departmental strategy to provide income support to fishers and plantworkers affected by the collapse of the groundfish stocks, as well as adjustment to employment outside of the fishery, reduction of industry capacity and renewal of the industry. Exhibit 15.2 sets out the initial and final funding levels for each of the TAGS program elements.

15.21 The capacity reduction element, the responsibility of Fisheries and Oceans

Industry Rationalization	Fisheries Management Renewal
TAGS – Groundfish licence retirement program	The new Fisheries Act • Partnerships or co-management
TAGS – Early retirement program	• Sanctions
Atlantic licence review	Science-based, precautionary approach
Professionalization Action 1997 1997	Integrated fisheries management plans
The new Fisheries Act	Conservation harvesting plans
• Partnerships or co-management	Enhanced catch monitoring
• Sanctions	Effective enforcement and compliance
Unemployment Insurance reform	Access fee increases
Access fee increases	Multi-departmental integrated registration and reporting

Note: Shading indicates initiatives included in the audit.

Exhibit 15.1

Initiatives toward the Rationalization and Renewal of the Fishery

The initial identification of "core" licence holders was to have been completed by 30 June 1994.

Canada, was approved in principle based on the number of groundfish licences being identified as the main factor in the overcapacity of the industry. In its initial approval of the program, the government indicated that a reduction of at least 50 percent was required. This reduction was to be accomplished through the buyback of licences and the provision of early retirement annuities for fishers, and the identification of a professional "core" group of fishers that would participate in the fishery when stocks had recovered; it was to be complemented by unemployment insurance reform. The licence buyback and early retirement programs would target those fishers that were to be included in the "core" group.

15.22 In December 1994, the government set criteria that limited the target population for licence buyback and early retirement to only full-time groundfish licence holders who had an annual fishing income of at least \$3,000 and for whom fishing represented 75 percent of earned income. In addition,

TOTAL

they had to be full-time fishers with seven years' experience. These criteria, called the Special Eligibility Criteria, set the target population for these programs at 6,200 licences, with a target of 2,000 licences to be retired by the licence buyback program.

15.23 When it became apparent that the level of funding set aside for TAGS income support was not going to be sufficient for the number of eligible individuals, the government reprofiled funds from capacity reduction to income support. See Exhibit 15.2 for an explanation of these and other reductions in funding for capacity reduction initiatives. For more detailed information on the problems associated with the funding for TAGS, refer to Chapter 16.

15.24 Identifying the "core" fishers. As noted earlier, TAGS capacity reduction included an initiative to identify a professional "core" group of fishers who would remain in the fishery when stocks had recovered. The initial identification of

Exhibit 15.2

Changes in the Funding Approved for Components of The Atlantic Groundfish Strategy

	Funding (\$ millions)	
	April 1994	March 1997
Human Resources Development Canada	1,550	1,748 *
Fisheries and Oceans Canada	300	97 **
Economic Development	50	50
TOTAL	1,900	1,895 ***
* See Exhibit 16.6 for details of funding ch	anges for income support	and labour adjustment
** Details of Fisheries and Oceans Canada Projected Expenditures	a (\$ millions)	
Groundfish Licence Retirement Program	m 59.7	
Early Retirement Program	28.5	
Operating Costs	8.3	

*** 5.2 million was transferred to NCARP - Plant Workers Adjustment Program

Source: Fisheries and Oceans Canada

96.5

"core" licence holders was to have been completed by 30 June 1994. Originally, the criteria for establishing who would be allowed to continue in the fishery were to be the same as those used in the TAGS capacity reduction exercise (namely the Special Eligibility Criteria). In December 1994, this exercise identified about 6,200 groundfish licences to be included in the "core" group and about 7,800 to be excluded.

- 15.25 There was an industry concern that the Special Eligibility Criteria were not appropriate for every Atlantic region, and that the Department should not impose any single set of criteria across all Atlantic fisheries. On 12 May 1995, the Minister announced that the Department would undertake a review of the licensing policy, including public consultation. The objective of the review was to promote multi-species licences and a "core" cadre of professional full-time fishers.
- 15.26 After consultation with the industry, the Department established four broad guidelines to be used in developing regionally based criteria. Fishers who would remain in the fishery would have to:
 - be the head of an enterprise;
- hold key licences (lobster, crab, active groundfish, etc.);
- have an attachment to the fishery; and
 - be dependent on the fishery.

Fishers who did not meet these guidelines would not be removed from the fishery, but their licences would be cancelled once they exited the fishery.

15.27 Criteria were developed in each of the Department's regions through consultation with industry to determine which fishers would be included under the

new licensing policy. In December 1995, the regional criteria were applied to the active groundfish licence holders in Atlantic Canada and Quebec (about 13,600). This process identified approximately 9,800 fishers to be included under the new licensing policy, while the remaining 3,800 fishers would remain in the fishery with limits placed on their ability to transfer their groundfish licences. The Department sent letters to the fishers who were excluded to explain the reasons and to inform them that they had the right to appeal the decision.

- 15.28 Subsequently, public protests by a segment of the groundfish industry raised concerns about the licence reform process. The Minister and departmental officials met with the fishers and considered their concerns. On 8 March 1996, after a number of meetings with the fisher groups and their representatives, the Minister announced that some of the criteria would be modified.
- 15.29 These changes resulted in an increase in the number of fishers included under the new licensing policy. As of December 1996, there were 10,435 groundfish licence holders included in the "core" and 2,626 excluded. See Exhibit 15.3 for a summary of the targets for fishers to be excluded from the "core", and the final results.
- 15.30 The results of the Atlantic licence review are lower than the initial target and will not be fully felt in the groundfish industry until some time in the future. The changes to the licensing policy effectively put a cap on the number of groundfish licences in the future. Nonetheless, the fishers who will remain in the fishery have historically accounted for a significant portion of the Atlantic groundfish harvested.
- **15.31 Licence buyback element.** The licence buyback element, eventually

The results of the Atlantic licence review are lower than the initial target.

Targets were not met due in large part to the reductions in program funding.

called the Groundfish Licence Retirement Program (GLRP), was to be administered by a federal-provincial board that would manage programs to reduce capacity in both the harvesting and processing sectors. Except for the Province of Newfoundland, the federal government was not able to get provincial participation. In October 1994, the federal government established four harvesting adjustment boards to carry out the licence buyback program. The harvesting adjustment boards were to operate independently of government. The boards were responsible for developing capacity reduction plans and providing advice and recommendations to the Department on eligibility issues. The boards were to make recommendations to the Department on the licences that should be retired. In December 1994, the government established terms and conditions for the program and the Minister began the process of accepting bids for the GLRP on 31 January 1995.

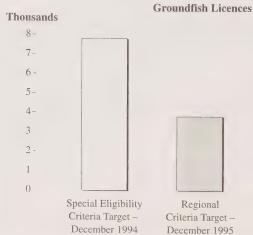
15.32 The harvesting adjustment boards developed capacity reduction plans that suggested setting \$500,000 as the maximum amount to be paid to an individual licence holder. It was believed that this would remove the most

harvesting capacity for the dollars expended. In August 1995, the capacity reduction plans were modified by the Treasury Board to reduce the maximum acceptable bid levels to \$350,000 for vessels over 35 feet and \$180,000 for vessels under 35 feet; vessels over 100 feet were excluded. The Treasury Board also required that 75 percent of the bids accepted be from licence holders with vessels under 35 feet. This was done so that all sectors would be affected in proportion to their historical share of the fishery.

15.33 The GLRP was conducted through a reverse auction bidding process (the lowest ratio of bid amount to groundfish landings wins). Two rounds of bidding were conducted; the first round of approved buyouts was announced in October 1995 and the second round in August 1996. In total, the GLRP retired 478 licences at a cost of \$59.7 million. The GLRP effectively had to "buy down" a future stream of guaranteed TAGS benefits. Approximately 38 percent of the cost of licences retired represented the cancellation of future TAGS benefits. With no more funding available and the program completed, the harvesting



Targets for Fishers to Be Excluded from the "Core", and the Final Results



Source: Fisheries and Oceans Canada

Licence Holders

Identified for

Eventual Removal

adjustment boards were dissolved except in Newfoundland, where that board continued to work jointly with the Province on these and other issues. The harvesting adjustment boards were not able to achieve the targets initially set for them due in large part to the reductions in program funding. The Treasury Board modifications to the maximum bid amount and the historical share condition reduced the probability that vessels with historically higher landings would be removed from the industry. Exhibit 15.4 shows the estimated impact of the Groundfish Licence Retirement Program in terms of value of landings and number of groundfish licences retired.

Early retirement element. The 15.34 early retirement element did not achieve the level of participation initially expected. It retired 333 fishers at a projected cost of \$28.5 million; of these,

67 fishers also held groundfish licences. The results of the early retirement element were largely affected by other aspects of TAGS. For example, fishers could remain on TAGS income support and receive financial support similar to that provided by early retirement while still retaining their groundfish licences.

Overcapacity remains

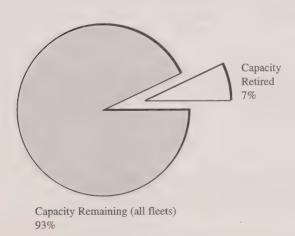
15.35 Exhibit 15.5 shows that the number of groundfish licences declined from 17,193 in 1993 to 13,061 in 1997, of which 10,435 represents the "core" group of fishers. However, a portion of this "core" group of fishers are the groundfish harvesters who historically caught most of the fish. Significant overcapacity still remains. Chapter 14 provides an historical perspective of the harvesting capacity problems associated with Atlantic groundfish.

Significant overcapacity still remains.

Exhibit 15.4

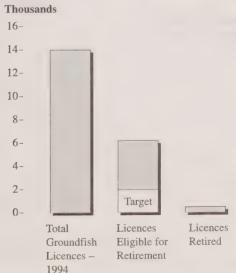
Impact of the Groundfish Licence Retirement Program in Terms of Value of Landings and Number of Groundfish Licences Retired

Estimated Capacity Impact -Average Value of Landings - 1986 to 1992



Source: Fisheries and Oceans Canada

Groundfish Licences



Harvesting capacity reduction without direct government intervention has been achieved in the offshore sector.

Other capacity reduction considerations

Harvesting capacity reduction without direct government intervention has been achieved in the offshore groundfish sector, a sector that historically represented approximately 40 to 50 percent of the catch. The companies in this sector are managed under a quasi rights-based system called Enterprise Allocation (they are granted a right to a specific share of the quota and the right to sell or transfer this to others). When the Enterprise Allocation system became permanent in 1988, the number of vessels in the offshore sector was greatly reduced. The decline of the groundfish stocks in the 1990s brought about further substantial reductions. The companies continue to retain their proportional share of the quota should fishing resume. An exception is the northern cod fishery, where the Minister has indicated that the offshore sector will not be allowed to fish until the inshore sector has returned to its historical catch levels.

15.37 The inshore sectors also have licence holders that participate in quasi rights-based management systems,

referred to as Individual Transferable Quotas (ITQ). Contrary to the offshore sector, these licence holders were eligible for the licence buyback program and 39 ITQ licences were bought under that program. The Department is holding the quota it bought pending a final decision on disposition (in at least one instance, the Department bought back quota but continues to permit it to be fished to fund research surveys by the ITQ fleet). Rights-based management systems are designed to allow industry rather than government to match the capacity with the available resource (a self-rationalizing system with no cost to government). In this case, the inclusion of ITQ licences in the buyback program provided a consistent approach with the remaining inshore licence holders. However, it did not permit the self-rationalizing rights-based approach to take effect.

Transfer of management responsibility to industry

15.38 As a result of the Program Review process, the Department established a strategic action plan that set out certain key intentions, including the

Exhibit 15.5

Changes in Groundfish Licences 1993 to 1997

Licences 1993			
"Frozen" inactive licences	(1,981)		
Retired under NCARP	(876)		
Attrition	(314)		
Licences 1994 14			
Licence buyback	(478)		
Early retirement	(67)		
Attrition 1994 to 1996	(416)		
Licences 1997	13,061		
Atlantic licence review – non-core licences	(2,626)		

Source: Fisheries and Oceans Canada

move toward sharing fisheries management responsibilities with industry. The *Fisheries Act* establishes the responsibilities of the Minister and the Department for the management of Canadian fisheries, which places certain limitations on the devolution of fisheries management responsibilities to the industry.

15.39 On 3 October 1996, the government introduced new legislation that, among other things, proposed the establishment of fisheries management partnering agreements. This would allow the Department and any fishers' representative organization to enter into agreements on:

- harvesting limits;
- conservation and management measures for a fishery;
- the development of sanction guidelines;
- the number of licences to be issued; and
- the funding arrangement for management of the fishery.

The Department would maintain responsibility for the assessment of groundfish stock status, setting overall resource harvesting levels, and managing intersectoral and interregional allocation and enforcement.

15.40 The proposed legislation died on the order paper when the House of Commons prorogued on 27 April 1997. The Department has continued to move toward increased industry involvement in fisheries management. Within the limitations imposed by the existing *Fisheries Act*, fishers and their representative organizations are increasingly involved in gathering scientific knowledge, developing conservation harvesting plans and

monitoring catches. The Department, in collaboration with industry, is working on a Code of Conduct for Responsible Fishing to promote conservation-based harvesting.

In the Maritime region, 15.41 community management boards have been established that set out specific harvesting measures (such as limits on the amount of fish that can be landed in a period of time, the means of sharing the resource among the participants and penalties for non-adherence) for the vessels operating in that community group. The responsibility for control of the conservation risks associated with these local fishing plans rests with the community management boards. Some of the measures included in the local fishing plans were previously considered by the Department to have had negative impacts on conservation. For example, the Department discontinued the use of individual trip limits in the early 1990s as it found that fishers tended to dump unfavourable species and small fish when subject to these controls. In this instance, the Department has indicated that trip limits are an interim measure that it believes will eventually lead to more effective conservation measures.

15.42 The Department is reorganizing and reducing its overall fisheries management activities (for example, at-sea observers, science and enforcement) in anticipation of increased fisher responsibility. It has indicated that its resources are scheduled to be reduced by 40 percent by 1999. There are potential risks to conservation should major changes to fisheries management occur prior to the industry's accepting responsibility.

15.43 The Department should ensure that accountability for the conservation and protection of the groundfish stocks is an integral part of any arrangements with industry to take on increased fisheries management responsibilities.

Department's response: The Department agrees that conservation must remain the primary objective and must not be compromised. This requirement is integral to all co-operative arrangements with harvesters, such as co-management agreements, preparation of conservation harvesting plans, and integrated fisheries management plans. Achieving a sustainable fishing industry through conservation-based harvesting needs to involve co-operative action with harvesters.

Fisheries Management Renewal

Common approaches exist in groundfish management

15.44 The strategy adopted by the Department for fisheries management renewal has implications for the way it conducts its business and the way it relates to the fishing industry. Since the collapse of the groundfish stocks, the Department

has made changes to certain of its key groundfish management activities.

The management of Atlantic groundfish stocks varies somewhat from stock to stock and from region to region, but there are some common characteristics. For instance, most of the stocks, certainly all of the significant stocks, are managed under a system of control over both quota and effort (for example, gear types and time allowed on the water). A quota is established for the weight of fish that can be harvested in a particular year. This quota is then allocated to various fisher groups based on their historical share of that fishery or on some other basis as determined by the Minister. An overview of the current groundfish management cycle is shown in Exhibit 15.6.

Knowledge-gathering processes need to be improved

15.46 The Department and industry support the gathering of knowledge about the marine environment and related fisheries so that they can better understand the biology of various groundfish stocks and, therefore, make informed decisions for the sustained use of the resource. All of these knowledge-gathering processes are designed to provide support to the





Research scientists gather information about the marine environment and the health of fish stocks (see paragraph 15.46).

Minister in the conduct of his legislative responsibilities under the *Fisheries Act*, including decisions about stock use.

15.47 It should be recognized that the Minister can never be provided with information on the groundfish stocks that is 100 percent precise. The stock assessment process is intended to gather the information necessary to minimize the risk inherent in the decisions made by the Minister on the use of stocks.

15.48 Canadian fisheries managers and scientists are knowledgeable and experienced, as evidenced by their representation on, and significant contribution to, many international

organizations dealing with fisheries. Yet the collapse of the groundfish stocks has provided ample evidence that there is still a great deal that must be learned by fisheries scientists and managers in Canada. Exhibit 15.7 sets out some of the past problems that the Department itself has identified in the knowledge-gathering processes. Canada is not unique in having to deal with these problems.

15.49 Stock assessments conducted by the Department rely on the completeness and accuracy of the information on catch and effort provided by industry and maintained by fisheries management, the level of understanding of the biology of

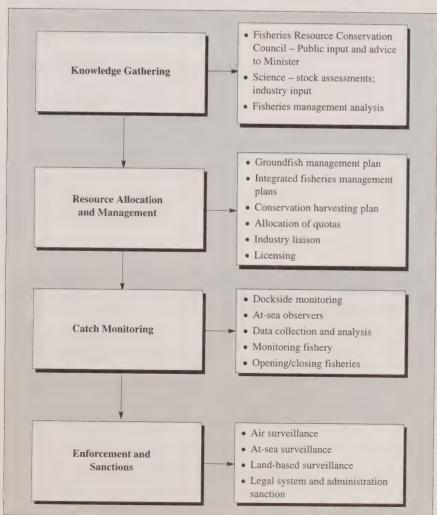


Exhibit 15.6

The Department's Groundfish Management Cycle

the stocks under study and the quality of the research surveys. We have observed that problems still exist in the processes used to collect information used in the stock assessments.

Fisheries scientists have informed us that there are still problems with the assumptions used in the models that are difficult to remedy. For example, fisheries scientists may never be able to get ongoing current information about such things as the percentage of a stock mortality due to natural causes; therefore, the level of natural mortality is assumed to be constant at about 18 percent for most stocks. Also, no allowance is made for unsustainable fishing practices because the Department has not estimated the impact of such practices for stock assessment purposes. Instead, it assumes that the level of unsustainable fishing practices remains constant from year to year. The absence of support for these assumptions adds to the uncertainty involved in the stock assessment process and, historically, it is the imprecise nature of the stock assessments that has permitted industry to pressure ministers for access to more fish.

15.51 Industry input into knowledge gathering. The Department has increased its effort to improve understanding of the biology of cod and, to a lesser degree, the other groundfish species. The Department has included the knowledge of fishers in the assessment of stock status, through fisher participation in the Regional Advisory Process review of the initial draft stock status report. In 1993, the Fisheries Resource Conservation Council was established, in response to the collapse of the groundfish stocks, to provide advice to the Minister on groundfish conservation issues, including appropriate quota levels. Council members are appointed by the Minister and include independent academics and representatives from industry, the provinces and the Department.

15.52 While industry participation has been beneficial in gaining industry acceptance of the stock assessments, the Science Branch has not been able to fully incorporate into the stock assessment process the information gained from the work conducted by fishers. This is especially true of the work conducted under the sentinel fisheries (a small-scale fishery that provides data on catch rates,

Exhibit 15.7

Past Problems Identified in the Gathering of Knowledge about Groundfish Stocks

- The quality of data provided by fishers to the Department on commercial fishery catch and effort has been poor. The Department and industry have recognized that the figures are understated and inaccurate. This information is an essential component of the stock assessment process.
- Since 1986, the Department has recognized that the model used to determine the status of
 most of the key groundfish stocks has consistently overstated their abundance and
 understated the level of mortality.
- The model incorporates the assumption that natural mortality is constant in nature while the
 fish stocks and their environment are continually changing. In many instances, the
 Department did not have the information that accurately reflected the current status of the
 stock.
- There were significant time lags between the research surveys and supporting scientific analysis and the final delivery of the stock status assessment and related advice to the Minister. There were further delays caused by the resource management planning process in place at that time. This meant that decisions on stock use did not necessarily reflect the current status of the stock.

distribution, migration, population structure and condition of fish and that is conducted by fishers using traditional gear types under the Department's direction and government funding). Among the problems associated with the sentinel fisheries are that they provide information for only two years, which is not long enough for appropriate analysis, and they are more expensive than the comparable coverage provided by the ongoing science program.

15.53 Research surveys. The research surveys conducted by the Department's scientists represent the longest-running series of independently gathered data about the status of individual groundfish stocks. The reliability of these data is dependent on an understanding of the biology of the surveyed stock. For example, the Department acknowledged that it did not have a good understanding of the composition and movement of the various cod stock components for the Northwest Atlantic Fisheries Organization (NAFO) fisheries zone 3Ps cod. The timing of the research survey has varied considerably over time (mostly February or April). The 1996 stock status report indicates, "The origins of fish that make up the 3Ps cod fishery are diverse and as yet not fully understood."

15.54 Guiding principles. The preceding chapter referred to the absence of measurable indicators related to the Department's guiding principles for the fishery of the future. The Department has indicated that to achieve a sustainable use of the stock, it must adopt such concepts as "new biological references to avoid critical zones" and the "precautionary approach to decision making". In the past, reference points have been used but have not been effectively implemented. To date, the Department has not established any new biological references for use in

the management of each of the individual groundfish stocks. The Fisheries Resource Conservation Council has provided examples of potential biological references in its report From Moratorium to Sustainability: Criteria for Re-opening and Sustainable Harvesting, but no action has been taken to implement these or any other potential guidelines.

In addition, key conservation decision rules have not been established to help guide decision making when applying the precautionary approach. The precautionary approach is described in Chapter 14, Exhibit 14.13. Department scientists are taking part in projects with various international organizations for the development of guidance on the precautionary approach. It is important that international organizations develop and agree upon guidance for the precautionary approach. Meanwhile, guidance that can be applied to the Atlantic groundfish stocks is required. Exhibit 15.8 reflects some of the difficulties associated with applying the precautionary approach in the absence of formal guidance.

The Minister requested the Fisheries Resource Conservation Council (FRCC) to develop a conservation strategy for Atlantic groundfish. The Department and the Council have worked together on developing concepts included in FRCC reports, including the recent FRCC report A Groundfish Conservation Framework for Atlantic Canada. Nevertheless, the Department has not yet achieved agreement with industry on long-term objectives for each of the groundfish stocks. Without biological reference points as guideposts, decisions on the use of individual stocks could be influenced by current social and economic factors rather than their biological sustainability. We noted that improvements have been

Guidance on the precautionary approach that can be applied to the Atlantic groundfish stocks is required.

made in the type of information presented in certain stock status reports, in the timeliness of information used in the stock assessments and in the interaction between industry and the Department in the stock assessment process.

Resource management planning is evolving

15.57 The Department had planned, as a part of its fisheries renewal initiatives, to develop an integrated approach to producing management plans for the 1996 fishing season in the groundfish fishery. This integrated management planning process was to have considered such things as:

- long-term objectives for each fishery;
 - · current management issues;
- key management measures for the upcoming year;
- conservation and protection issues and strategies;
 - industry responsibilities; and
 - evaluative criteria.

15.58 While the Department has not yet formalized its integrated management planning process for groundfish, there has been progress toward this concept in the significant fisheries off southwest Nova Scotia. Industry and fisheries management have undertaken an ongoing series of meetings designed to deal with

Exhibit 15.8

Reopening of the 3Ps Cod Fishery and the Application of the Precautionary Approach On 17 April 1997, the Minister announced his decision to allow 10,000 tonnes of cod to be caught in NAFO fishing zone 3Ps or approximately 30 percent of the quota prior to the moratorium. The decision to reopen the 3Ps cod fishery was made after receiving the recommendation of the Fisheries Resource Conservation Council (FRCC) and advice from the Department.

Sources of information for the decision on 3Ps included the stock status report, the inshore sentinel fishery and public input to the FRCC. These sources provided information that was contradictory and raised uncertainties about the status of the stock. How was the precautionary approach applied in this instance?

Some major uncertainties raised in the stock status report include the following:

- The research vessel survey did not show any increase in the estimates of abundance in the offshore areas; historically, these areas are where the largest portion of the biomass would be found from late fall to early spring of the year.
- Scientists did not feel that they could provide a credible estimate of the total or spawning stock biomass.
- The stock is heavily dependent on fish that were spawned in 1989, with negligible recent recruitment of young fish.
- The productivity of the fish still remains at the lowest levels observed.

The stock status report itself leaves the reader with uncertainty. For example, the report states, "Based on the available data, a limited re-opening of the inshore fixed gear fishery may not compromise the recovery of the stock." The report highlights the risks of depletion of the stock, given its current state, but does not suggest a specific level of harvest.

We are not concluding that the precautionary approach was not applied in this decision. We believe that the 3Ps example points to the difficulty of making resource utilization decisions in situations of uncertainty and the need for guidance in applying the precautionary approach.

Further, it should be noted that the 1997 conservation harvesting plan for the 3Ps cod fishery contained many conservation measures designed to ensure that the quota was not exceeded. Such conservation measures were not in place prior to the moratorium.

management and conservation issues. However, even in this area, we noted numerous cases where management planning was not conducted in an integrated fashion. For example, long-term objectives were not established and enforcement considerations were not incorporated into the management plans.

15.59 Conservation harvesting plans (CHPs) were initially introduced for the management of certain stocks that were in decline. CHPs are prepared by the various groundfish fleet sectors and include different conservation measures that each sector will follow, such as spawning area closures, gear selectivity and bycatch limits. During the 1996 season, all groundfish fleet sectors had to prepare a CHP and obtain approval for it from the Department before they began fishing.

Catch monitoring processes have deficiencies

15.60 The Department has two main processes to monitor catches; namely, the dockside monitoring program and the at-sea observer program. The purpose of these processes is to provide fisheries managers with timely, complete and accurate commercial catch data to manage fisheries, including the stock assessment process. The dockside monitoring

program has been gradually introduced to different fisheries since 1992. The program calls for fishers to self-report, through the dockside monitoring organizations, on fish landings. Under the previous system, the fish buyers reported their purchases.

15.61 Dockside monitoring program.

The dockside monitoring program has become the Department's key source of data on the amount of fish landed. Under this program, fishers procure the services of a dockside monitoring organization to monitor and report on their landings of fish. The individual dockside observers hired by the organizations are certified to perform their duties by Fisheries and Oceans Canada. While this program represents an improvement over the previous system, we observed weaknesses in the control environment for dockside monitoring, which include the following:

- The Department does not have the authority to control the activities of the organizations that carry out the monitoring. For example, it has established standards for the conduct of dockside monitoring but has no authority to ensure that the organizations work to those standards.
- The Department cannot ensure that the organizations that carry out these activities and the observers whom they

The Department has not yet formalized its integrated management planning process for groundfish.





Fishers are required to report on fish landings (see paragraph 15.60).

While the dockside monitoring program represents an improvement over the previous system, we observed weaknesses in the control environment.

employ are independent of the fishers they monitor.

- The Department has not undertaken sufficient measures to determine whether the dockside monitoring program is producing complete and accurate data.
- The Department has not evaluated the dockside monitoring program's effectiveness in contributing to groundfish conservation.

See Exhibit 15.9 for examples of specific deficiencies noted in the Department's dockside monitoring activities.

15.62 At-sea observer program. It is very difficult for the Department to get good information on the industry fishing practices at sea. The at-sea observer program is one means by which the Department's fisheries managers have historically obtained such information. In this program, the Department has independent observers accompany and monitor fishers while they are engaged in fishing activity. The observers obtain data and information vital to the stock assessment process and other important fisheries management activities.

15.63 A benefit and also a limitation of the at-sea observer program is that fishers are not likely to conduct unsustainable fishing activities when an observer is onboard. However, only the largest of fishing vessels have 100 percent coverage by observers; all other vessels are observed on a percentage basis. Therefore, the impact of the program may be limited to those vessels that are observed. To overcome this, the Department could prepare an "index" of the catches by observed vessels or vessels that have been subject to at-sea surveillance by enforcement officers. This "indexed" catch would then be compared with the catches reported by all of the other vessels. While this type of analysis can be very complex and difficult to complete, it would yield important information about the unsustainable practices of industry and would support the Department's enforcement activities.

15.64 For example, we identified an analysis completed by departmental officials for one groundfish fleet sector in southwest Nova Scotia. This study established an estimate of the extent of unsustainable fishing practices in that fleet during a given period. The Department

Exhibit 15.9

Deficiencies in Dockside Monitoring Program

Examples of specific deficiencies in dockside monitoring activities:

- The Maritime region has conducted administrative reviews of the dockside observers and spot checks by enforcement officers. These reviews have noted instances where the observer could not identify species of fish, did not ensure that the fish were properly weighed and did not check that the vessel was completely offloaded when the landing was complete. The Department has not quantified the potential error resulting from these weaknesses.
- The dockside monitoring program is not always carried out by organizations that are at arm's length with the harvesting sector. For example:
 - In the Newfoundland region, dockside monitoring is conducted by an organization associated with the union that represents the vast majority of fishers in the region.
 - In the Maritime region, one of the dockside monitoring companies is predominantly owned by family members of fishers engaged in groundfish harvesting.
- The Department does not require that all fish be weighed at the wharf. In some instances, fish are moved from the vessel to the processing plant, which can be a significant distance from the unloading site. This increases the possibility that dockside observers would not be able to ensure that all fish landed would be included in the Department's catch data systems.

has not developed a systematic approach that integrates at-sea observer and other information into its management practices.

15.65 In the future, the Department will require industry to pay for the at-sea observer portion of the cost of the program. The level of observer coverage for each fleet sector will be subject to negotiation between the Department and industry. The Department has not yet developed standards for at-sea observer coverage that could assist in its negotiations with industry.

Enforcement is not fully integrated into groundfish management

As stated in paragraph 15.11, 15.66 fisheries management planned to increase its sharing of management responsibilities with industry. As part of that strategy, the Department moved to reorient the activities of its Conservation and Protection Branch (referred to as enforcement), from an emphasis on enforcement of fisheries regulation to auditing, where possible, programs of monitoring funded by industry and run by private enterprises (such as dockside monitoring and at-sea observers). The Department has made limited progress toward this objective. During the audit, the Newfoundland region started to make changes to its enforcement function and the Branch has started developing work plans based on a risk analysis.

15.67 Existing information systems do not always meet enforcement needs. Our review of the catch monitoring processes indicated that they do not provide the information needed for effective enforcement. For example, the information received from both the at-sea observers and the catch data system does not give enforcement officers the lead time to plan their enforcement activities.

In addition, there are problems associated with the data being used by the enforcement function. The Department is aware of these problems and has a project in place that, among other things, will attempt to provide the information that the enforcement function needs. In addition, the Department has indicated that there is a need to train enforcement officers in the use of the existing information systems.

15.68 Groundfish not always given enforcement priority. We observed that in most districts with significant groundfish fisheries, enforcement effort has been diverted away from the groundfish industry to other fisheries where the potential is greater for successful identification of violations of fisheries regulations. In these districts. enforcement officials informed us that they do not have the resources and/or understanding of what the Department expects of them when conducting enforcement for groundfish. In 1996, the Department removed several administrative responsibilities (for example, the issuing of licences) from the enforcement function, which should allow for more time to be spent on enforcement duties.

15.69 Sanctions. When the Department catches a fisher violating regulations, it has the authority to charge the individual and have the fisher tried before a court of law. In 1993, the Department developed the Administrative Licence Sanction Policy under which, should a serious conservation-related offence occur, the Regional Director General could apply an additional sanction or suspend the right to fish for a period of time.

15.70 While some regions have applied the sanction policy aggressively, others either have failed to apply it at all or have only partially implemented it. The implementation of the policy was left to

The Department has not developed a systematic approach that integrates at-sea observer and other information into its management practices.

Enforcement effort has been diverted away from the groundfish industry to other fisheries.

The Department and the industry have indicated that sanctions are an important mechanism to deter unsustainable harvesting practices.

the discretion of the regional officials, which accounts for the differences in its application.

15.71 The legality of the policy has been challenged on several occasions. Due to recent court rulings, the legal status of the policy is not clear. While the Department is appealing these recent decisions, it has indicated that it will continue to prosecute violations through the courts while sanction action is put on hold. The Department and the industry have indicated that sanctions are an important mechanism to deter unsustainable harvesting practices.

15.72 The Department should:

- improve its catch monitoring systems to ensure the accuracy and completeness of the commercial catch data that are used for fisheries management and stock assessment purposes;
- develop working interpretations or definitions of such key principles or concepts as the precautionary approach and biological reference levels;
- ensure that integrated fisheries management plans link the Department's conservation principles and related measurable objectives with departmental resource planning for individual fisheries;
- address the weaknesses in the dockside monitoring program;
- ensure that enforcement is an important and active function that is conducted based on an appropriate analysis of conservation risks and that provides assurance about the effectiveness of catch monitoring processes; and
- ensure that enforceable mechanisms for deterring unsustainable harvesting practices are in place.

Department's response: The Department agrees that improvements can be made to strengthen conservation management practices, and has initiatives under way to address the issues identified. Internal controls are being redesigned to improve the reliability of catch information from dockside monitoring programs. Integrated Fisheries Management Plans are being designed by the Department in co-operation with representatives of fleet sectors in the Atlantic. The enforcement program is being redesigned and strengthened. Stringent groundfish reopening measures have been adopted for deterring unsustainable harvesting practices. The Department has been and continues to be highly influential in the development of the precautionary approach to fisheries management. The Department notes that the precautionary approach is a new concept (outlined at the 1995 Conference on Straddling Fish Stocks and Highly Migratory Fish) for which biological reference points and conservation decision rules have not yet been established anywhere in the world. International Commissions such as the Northwest Atlantic Fisheries Organization and the International Council for the *Exploration of the Sea are currently* working on this issue and the Department will continue to work closely with the Fisheries Resource Conservation Council on the development and implementation of a Groundfish Conservation Framework for Atlantic Canada.

Conclusion

15.73 The Atlantic Groundfish Strategy (TAGS) and other related initiatives such as licensing reform, unemployment insurance reform and fisheries management changes have not resulted in the removal of a significant amount of real or "fish catching" harvesting capacity that existed in the period prior to 1992. The Strategy and the other initiatives targeted the removal of 50 percent of the groundfish licences as the capacity

TAGS and other related initiatives have not resulted in the removal of a significant amount of real or "fish catching" harvesting capacity.

reduction objective over the long term. The decrease in TAGS capacity reduction funding from \$300 million to \$97 million had an impact on the Department's ability to remove more licences. For the most part, the licence holders removed or to be removed by the initiatives do not represent the fishers that historically caught most of the fish.

15.74 Since the introduction of TAGS, the number of licences that have been removed represents approximately four percent of the licences that existed at that time. A further 19 percent have been targeted for eventual removal through the Atlantic licence review. The changes to the licensing policy effectively put a cap on the number of groundfish licences in the future. The eventual removal of approximately 23 percent of the groundfish licences shows progress but overcapacity still remains.

Past management practices were introduced with the objective of achieving conservation, but, for various reasons, without success in protecting the resource base. Since 1992, the Department has been introducing further changes to its groundfish management activities. Since 1994, these changes have been focussed on the Department's strategy that flowed from the Program Review exercise. We found that improvements have been made in certain fisheries management activities, but there are areas where progress has been slow or deficiencies of the past continue to exist. These areas include implementing a precautionary approach to conservation and improving catch monitoring and enforcement.

15.76 Changes planned for the renewal of fisheries management are based on the assumption that the restructuring of the industry and the changes in its relationship with the Department will take place. In the groundfish sector, few fisheries

management responsibilities have been transferred to industry. The transfer has not occurred in part because of legislative limitations but also due to the inability of some segments of the industry to accept greater responsibility. We are concerned about the potential conservation impacts of changes to fisheries management without the planned transfer of increased responsibility and accountability to industry occurring at the same time.

Department's comments: This report confirms the significant role of the fishery in the economy of Atlantic Canada and the importance of ensuring that the fishery resource is capable of supporting a sustainable fishery industry. The Department believes that it is important to "stay the course" and continue with its program of Fisheries Management Reform and Renewal. While more needs to be done, much has been accomplished to ensure the conservation of Atlantic fisheries, including:

- science partnership with industry such as for sentinel fisheries;
- creating the Fisheries Resource Conservation Council;
- a new Atlantic commercial licensing policy;
- implementation of capacity reduction measures to the full extent of the Department's authority;
- strengthening of fisheries enforcement;
- the Canada-European Union Agreement to curtail foreign overfishing;
- new management structures such as integrated fisheries management plans and partnerships or co-management arrangements;
- collaboration with industry on a code of conduct on responsible fishing; and
- industry conservation harvesting plans involving: small fish protocols, zero

tolerance for discarding, tightened bycatch control, spawning and juvenile fish closures, effort reduction and control, improved dockside monitoring, at-sea observers, and gear selectivity and restrictions. Working together with the fishing industry, the Department of Fisheries and Oceans is committed to conservation and a sustainable fishery.



About the Audit

Scope and Approach

The main subject of this audit was the industry rationalization and fisheries renewal initiatives and their impact on the Atlantic groundfish industry. The audit covered the capacity reduction elements of The Atlantic Groundfish Strategy, and other fisheries management initiatives that are listed in Exhibit 15.1. It should be noted that several other initiatives could have some impact on Atlantic groundfish rationalization but were not the subject of this audit. They include unemployment insurance reform and access fee increases. These areas were not covered in this audit as their impact on industry rationalization would be indirect.

The Atlantic groundfish industry is regulated by both the federal and provincial governments. The federal government is responsible for the harvesting sector and the export of fish products from Canada, while the provincial governments are responsible for the processing sector. The regulation and management of the Atlantic groundfish processing sector has significant impacts on the federal government's management of the harvesting sector. For example, the existence of overcapacity in the processing sector puts significant pressure on the federal government to provide groundfish necessary to operate the plants. While we have taken the processing sector into account during the conduct of the audit, it was not the subject of the audit.

Objective

This chapter assesses whether fisheries management practices for the Atlantic groundfish fishery have resulted in progress in dealing with the fundamental problems in the fishery. In addition, it assesses the extent to which the capacity rationalization initiatives administered by the Department have contributed to the achievement of both fisheries management and The Atlantic Groundfish Strategy objectives.

Criteria

We would expect that:

- fisheries management practices would ensure that industry capacity is in balance with fisheries resource levels;
- fisheries management practices would ensure appropriate involvement of industry and communities and ensure that industry is held accountable for following sustainable fishing practices; and
- groundfish management practices (science, fisheries management and enforcement) would implement the principle of conservation to ensure sustainable stocks.

Audit Team

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Chapter 16

Human Resources Development
Canada — The Atlantic
Groundfish Strategy

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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Human Resources Development Canada — The Atlantic Groundfish Strategy

Main Points

- 16.1 The accountability framework for The Atlantic Groundfish Strategy (TAGS) has significant weaknesses that have had an impact on the value obtained for money spent. These include the following:
 - the responsibilities of the organizations charged with developing and implementing TAGS were not clearly defined or agreed upon in a memorandum of understanding;
 - no overall strategic plan was established to identify and schedule the activities of the organizations responsible for implementing TAGS and to determine the indicators and performance expectations to be used, monitored and reported on;
 - no formal co-ordination mechanism was envisaged, even though TAGS involved joint activities because of its interdependent components; and
 - the information submitted to Parliament did not make it possible to determine progress toward TAGS
 objectives of restructuring Atlantic Canada's fishing industry to make it economically viable and
 environmentally sustainable.
- 16.2 The timetable for developing an initiative as important as TAGS was unrealistic. It was not geared to the restructuring of the industry. The funds (\$1.9 billion) were distributed according to a preliminary strategy, but subsequently had to be reallocated among TAGS components because of major changes to the initial strategy and because forecasts of the eligible population had been too low.
- 16.3 The information needed to assess participant eligibility was not always available. Because clear, accurate information was difficult to obtain, decisions were made on the basis of incomplete information that did not meet the requirements of TAGS eligibility criteria. Errors in applying the criteria were noted from the time TAGS was implemented, and many corrections had to be made. Varying interpretations of the eligibility criteria resulted in different treatment of participants in various areas.
- 16.4 The results of the labour adjustment component of TAGS will not be known. Program evaluation efforts were abandoned when the Strategy changed from an active participation strategy to a passive one. We are concerned that the information gathered and the lessons learned during an initial evaluation of program development and implementation may be lost and that results will not be accounted for.
- 16.5 The government proposes to review the longer-term issues arising from the elimination of TAGS foreseen in May 1998. We urge the government to examine carefully the consequences and impacts of the decisions made under TAGS in order to benefit from the valuable lessons that can be learned.



Introduction

16.6 This is one of three chapters on the fisheries of the future. It focusses on The Atlantic Groundfish Strategy (TAGS), in particular the labour adjustment component, for which Human Resources Development Canada is responsible, and the accountability framework. Chapter 14 deals with the historical, biological. economic and social context in which Fisheries and Oceans Canada manages groundfish, and reviews the causes of the current crisis and the federal government's response to it. Chapter 15 examines Atlantic groundfish fishery management practices to determine whether they have led to progress in resolving the basic problems in the fishing industry, and establishes the extent to which capacity reduction efforts administered by Fisheries and Oceans have contributed to the implementation of TAGS.

The Atlantic Groundfish Strategy

- 16.7 In July 1992, the Northern Cod Adjustment and Recovery Program (NCARP) was introduced to assist fishers and plant workers affected by the two-year moratorium on the northern cod fishery. In April 1993, the Atlantic Groundfish Adjustment Program (AGAP) was also put in place to assist fish plant workers affected by declining groundfish stocks. Both NCARP and AGAP expired on 15 May 1994.
- 16.8 In the winter of 1993–94, the Fisheries Resource Conservation Council determined that, despite the northern cod moratorium and the reduction in groundfish quotas in December 1992, groundfish stocks were continuing to decline. The Cashin Task Force reported in November 1993 that the groundfish industry was facing a crisis of catastrophic proportions, and that fish stocks would not

return to commercially exploitable levels before the end of the century. The report stressed that the groundfish industry of the future would be smaller, and that over half the jobs in the fishery would disappear.

- 16.9 In response to the crisis, the Minister of Finance announced, in the February 1994 Budget speech, a five-year program for the long-term adjustment of the Atlantic groundfish fishing industry. The Atlantic Groundfish Strategy was announced in April 1994, and came into effect on 16 May 1994. It covered fishing areas in five provinces: Newfoundland, Prince Edward Island, Nova Scotia, New Brunswick and Quebec. TAGS provided assistance programs for individuals and communities affected by the groundfish moratorium. The development of the Strategy was based on a set of guiding principles (see Exhibit 16.1).
- **16.10** The objectives of TAGS were to restructure the fishery industry in Atlantic Canada to make it economically viable and environmentally sustainable by:
- renewing the resource and reducing harvesting and processing capacity;
- facilitating the labour adjustment of individuals affected by the Atlantic fishery crisis;
- enhancing the profession of those fishers who remained active in the fishery industry; and
- facilitating community economic development by focussing on regional strengths and opportunities in the areas affected by adjustments in the fishery industry.
- 16.11 The implementation of TAGS involved four federal government organizations and had a fixed budget of \$1.9 billion over five years. The allocation of these funds was adjusted as the Strategy evolved. The duration period will be about

The Minister of
Finance announced, in
the February 1994
Budget speech, a
five-year program for
the long-term
adjustment of the
Atlantic groundfish
fishing industry.

four years and funds are currently allocated as follows:

- the Department of Fisheries and Oceans (DFO), responsible for the restructuring of the fishing industry (\$97 million);
- Human Resources Development Canada (HRDC), responsible for labour adjustment, including income support (\$1.748 billion); and
- the Atlantic Canada Opportunities Agency (ACOA) and the Federal Office of Regional Development – Quebec (FORD–Q), responsible for community and regional economic development (\$50 million).
- 16.12 These organizations were also to work with provincial and municipal governments, educational institutions and the private sector to implement TAGS.
- 16.13 TAGS incorporated complementary and interdependent activities. The first step was to identify a core group of fishers and fish processing plants that would continue to be part of the fishing industry. Identifying this core group would allow adjustment measures

to be directed according to participants' needs. Long-term regional and community economic development would subsequently increase employment opportunities and guide the direction of training.

- 16.14 Income support was to be provided to fishers, trawler workers and plant workers affected by the Atlantic groundfish crisis who agreed to participate in the labour adjustment programs offered under TAGS. The active participation measures were designed to facilitate access to employment through, for example, career planning and counselling, mobility assistance and support for re-employment; to prepare individuals for work through, for example, literacy and basic skills training; and to enhance employment opportunities through such means as support for entrepreneurship and restoration of the environment and communities, Human Resources Development Canada also administered the early retirement program for older plant workers.
- **16.15** Complementing the measures under TAGS, Unemployment Insurance

Exhibit 16.1

The Atlantic

Groundfish Strategy

(TAGS) incorporated

complementary and

interdependent

activities.

Guiding Principles for the Development of The Atlantic Groundfish Strategy (TAGS)

TAGS should:

- provide an integrated approach to capacity reduction and the adjustment of communities and individuals affected by the moratorium;
- call for partnerships with all stakeholders;
- identify a core group of professional fishers;
- harmonize active adjustment measures to the future needs of the groundfish fishery;
- emphasize career planning and employment counselling;
- link income support to active adjustment measures and take fiscal realities into account;
- base applicant access and eligibility duration on previous attachment to the groundfish fishery;
- emphasize sustainable development and Atlantic Canada's long-term economic development;
- recognize that the industry will be restructured to reduce capacity by 50 percent.

TAGS must not:

- be constrained by current policy and programs;
- in the absence of the fishery, base income support on unemployment insurance.

Source: Human Resources Development Canada

was changed to Employment Insurance effective in January 1997. The aim was to help those most in need and to provide incentives for beneficiaries to return to work. Changes were introduced to solve basic structural problems such as "disincentives" to work, dependence on unemployment insurance, administrative complexity and inequities in the system. The effects of these measures will not be known for a number of years. In May 1997, the Government of Canada announced that a temporary change would be made to the Employment Insurance Regulations that would enable all TAGS beneficiaries to qualify for unemployment benefits under regular entrance requirements.

Focus of the audit

16.16 The objectives of this audit were to determine whether:

- the income support and labour adjustment programs administered by Human Resources Development Canada contributed in an economical and efficient way to the achievement of TAGS objectives; and
- an effective accountability framework had been established for TAGS.
- **16.17** Details of our audit scope and criteria can be found at the end of the chapter, in the section entitled **About the Audit**.

Observations and Recommendations

An Incomplete Strategy

16.18 The Atlantic Groundfish Strategy was developed quickly by HRDC and Fisheries and Oceans, between January and April 1994. Subsequently, to take into

account unforeseen events and additional factors not thought of initially, many changes had to be made. Exhibit 16.2 summarizes the development of TAGS and shows that, in order to meet its income support commitment, between January 1995 and July 1996 the government had to reprofile funds from its planned measures to reduce fishing capacity, from its labour adjustment measures for active participation, and from administration. Moreover, to avoid exceeding the financial envelope, TAGS will end when funds are exhausted, which could be as early as May 1998, one year earlier than planned.

Because TAGS was replacing two 16.19 earlier programs that terminated on 15 May 1994 (see paragraph 16.7), a transition period of nine months was provided to maintain continuity. The deadlines for submitting applications varied according to the clientele. The labour adjustment component had to be developed and approved before TAGS came into effect, and mechanisms for applying to TAGS and for the initial payment to participants had to be put in place quickly. Exhibit 16.3 shows the timetable established by HRDC for the first year of TAGS.

16.20 TAGS was not fully developed when it came into effect on 16 May 1994. The partnerships needed to implement the Strategy's proposed concepts still had to be negotiated and TAGS components related to industry restructuring and economic development had not been finalized.

16.21 Income support was intended for those affected by the groundfish moratorium. To be eligible for TAGS programs, applicants had to agree to participate actively in labour adjustment measures (Exhibit 16.4 presents a profile of TAGS participants). It was therefore

On 16 May 1994, the partnerships needed to implement the Strategy's proposed concepts still had to be negotiated.

important that participants have a clear picture of their status. To be able to make career decisions early in the Strategy, eligible fishers and plant workers had to know if they could expect to be part of the industry in the long term or if they should find another job or retire.

16.22 These were potentially complex decisions for individuals. TAGS participants had to consider factors like choosing a career direction, finding out what jobs were available and where, and what type of effort would be required, as well as reconciling personal needs with those of their families. Knowing which enterprises would be targeted by reduction efforts was thus a priority.

16.23 Initially, TAGS planned to identify by June 1994 a core group of fishers and fish processing plants likely to be part of the fisheries of the future, based on criteria to be established in consultation with the provinces and the industry. Federal measures of capacity reduction — early retirement and fishing licence buybacks — would apply to fishers in that group.

16.24 As early as August 1994, Fisheries and Oceans acknowledged that reduction of fishing capacity would occur only in the long term, and that TAGS measures would be limited to areas of federal jurisdiction and would not alone be enough to reduce the industry by the desired 50 percent. Other measures such

Exhibit 16.2

Development of The Atlantic Groundfish Strategy

	g or modifying TAGS			
March 1994	Approval of guiding principles and the financial envelope of \$1.9 billion			
April 1994	Approval of the spending profile for the next five years and the Labour Adjustment component			
May 1994	TAGS becomes effective			
October 1994	Approval of the Fishing Industry Restructuration component			
July 1996	Harmonization of income support payments with employment insurance, as of 1 August 1996:			
	• an income ceiling of \$26,000 to be placed on eligibility for TAGS income support			
	 eliminating eligibility for TAGS income support during the two-week waiting period for TAGS participants who are entitled to employment insurance benefits 			
Decisions to avoid	exceeding the financial envelope of \$1.9 billion			
January 1995	HRDC active participation programs are more carefully targeted to reduce the projected TAGS deficit by \$385 million			
January 1995 July 1996	HRDC active participation programs are more carefully targeted to reduce the projected TAGS deficit by \$385 million Measures taken as of 1 August 1996 to prevent a projected deficit of \$500 million:			
v	the projected TAGS deficit by \$385 million Measures taken as of 1 August 1996 to prevent a projected deficit of \$500			
v	the projected TAGS deficit by \$385 million Measures taken as of 1 August 1996 to prevent a projected deficit of \$500 million: • Human Resources Development Canada – of the funds earmarked for administration and active labour adjustment measures, \$190 million to be allocated to income support • Department of Fisheries and Oceans – of the funds earmarked for			
v	the projected TAGS deficit by \$385 million Measures taken as of 1 August 1996 to prevent a projected deficit of \$500 million: • Human Resources Development Canada – of the funds earmarked for administration and active labour adjustment measures, \$190 million to be allocated to income support			

as unemployment insurance reform, a new licensing policy, the establishment of permanent agencies, provincial reduction of fish processing capacity, and economic development would have to be part of the solution. However, the impact of this new direction on the costs and operations of the other TAGS components was not assessed when the decision was made, and proved to be one of the factors in the increased demand for funds allocated to income support.

16.25 For the purposes of TAGS adjustment and industry reduction measures, the core group of fishers and fish processing plants was limited by Special Eligibility Criteria applicable only to groundfish fishers. By the summer of 1995, Fisheries and Oceans had identified some 6,200 fishers as qualifying under these criteria. Subsequently, a similar

process took place but for licensing purposes and 9,800 fishers were designated in early 1996 as qualifying for the fishery of the future.

In December 1996, a further review designated 10,435 groundfish fishers to be part of the fishing industry (see Chapter 15, paragraphs 15.24, 15.27 and 15.29). These successive processes did not serve to clearly identify individual situations.

16.26 The proposed community economic development measures to be developed by ACOA and FORD–Q were intended to create jobs in the communities affected by the restructuring of the fishing industry. Active labour adjustment measures could have led TAGS participants to direct their adjustment efforts toward the job opportunities thus created. In January 1995, HRDC still did

As early as August 1994, Fisheries and Oceans acknowledged that reduction of fishing capacity would occur only in the long term.

Implementation Timetable – Human Resources Development Canada

Planned Date	Activity
April 19, 1994	Announcement of TAGS
April 21, 1994	Mailout of application forms and explanatory letters to all participants of the Northern Cod Adjustment and Recovery Program (NCARP) and Atlantic Groundfish Adjustment Program (AGAP)
May 15, 1994	End of NCARP and AGAP benefits
May 16, 1994	TAGS becomes effective
May 30, 1994	First transition cheques are issued (covering the period May 16–29) and payments to new applicants and those rolled over
June 1, 1994	Initial contact with qualified clients (information and counselling)
July 1, 1994	Career planning and formulation of an action plan for eligible clients (includes selection of program options)
July 9, 1994	Last day of benefits for NCARP and AGAP roll-over beneficiaries who did not submit an application form under TAGS
July 1 to December 31, 1994	Identification of a core group of fishers
December 31, 1994	End of transition period. Benefits end for those rolled over but not eligible under TAGS
December 31, 1994	Last day to apply for the Fisher and Plant Older Worker Adjustment Program
March 31, 1995	Last day to submit an application form under TAGS

Source: The Atlantic Groundfish Strategy (TAGS) Guide, Human Resources Development Canada, December 1994.

The number of participants eligible for TAGS was 51 percent higher than expected.

not know what direction these measures would take.

16.27 The development and implementation of TAGS did not help the eligible population to understand the situation it was facing. The enterprise closures and layoffs that would result from the restructuring of the industry remained impossible to foresee, as did future opportunities for other employment.

Optimistic funding forecasts

16.28 The number of participants eligible for TAGS was 51 percent higher than expected. The forecast of costs of income support over five years had been based on an estimated eligible population of 26,500 participants (Exhibit 16.5 shows the difference between forecast and actual eligible population). Of the nearly \$2 billion devoted to TAGS, 76 percent is currently allocated to income support, whereas the forecast had been 36 percent. Many of the factors used to establish the

forecasts had been either underestimated or overestimated.

16.29 There were no existing data on the number of days spent on groundfish fishing over the course of a year, or on the percentage of a fisher's income that it provided. Similarly, there were no data on the time spent by plant workers to process groundfish or on the income they derived from it.

16.30 The forecasts were therefore based on the number of participants in previous programs. Fisheries and Oceans data on fish plant workers were based on employee lists at a given time, whereas HRDC data included all individuals who had worked in the sector and had paid unemployment insurance contributions. Consequently, their estimates of TAGS target population were inconsistent, at 31,000 and 39,000 respectively.

16.31 The departments had even less information on the population that had not been affected previously by a moratorium. Consequently, they had to make

Exhibit 16.4

Profile of Participants Eligible for The Atlantic Groundfish Strategy

	Men	Women	Total
Number of eligible participants as of 31 March 1997	22,519	11,581	34,100
Without high school education			73%
Age:			
<35	35%	28%	33%
35–54 55+	55%	64%	58%
	10%	8%	9%
Family status:	1070	670	9%
Spouse and children	51%	50%	
Spouse, no children	30%	37%	
Single parent	1%	5%	
Lives alone	5%	3%	
Others	12%	5%	
Other family members eligible for TAGS			
I IAOS	37%	51%	42%

Source: Human Resources Development Canada

assumptions about the number of potential participants and these may have greatly influenced the forecasts.

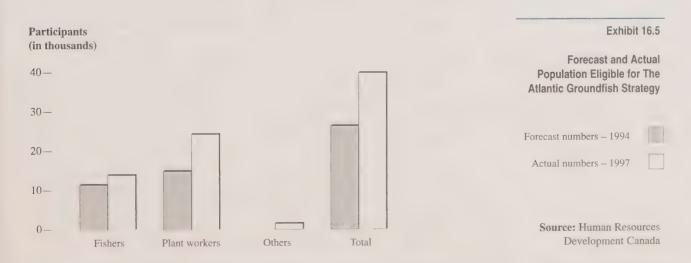
16.32 TAGS eligibility criteria had to be adjusted to this situation. They targeted individuals who worked in a fishing enterprise or fish plant for which groundfish represented at least 25 percent of its landed value or its processed volume. While individuals qualifying for TAGS under these criteria may have worked only in groundfish-related activities, as the available data pertained to establishments and not the individuals, others could qualify who had no attachment to the groundfish (see paragraphs 16.53 to 16.62).

16.33 Although the income support rate under TAGS was six percent lower than under the Northern Cod Adjustment and Recovery Program, the economic environment and several aspects of TAGS encouraged a high participation rate. The continuing decline in groundfish stocks discouraged fishing in the sector, and so it became increasingly difficult for individuals dependent on the groundfish fishery to accumulate enough insurable weeks of work to qualify for unemployment insurance benefits.

16.34 Individuals eligible for the entire duration of TAGS had the choice between a guaranteed income with regular payments over the course of the year, and seasonal employment to which unemployment insurance benefits could be added (or social assistance if they did not have enough weeks of work to qualify for unemployment insurance). Being part of a core group of fishers and fish processing plants and ultimately part of a more stable industry than before, and with a potentially higher rate of income, was an attractive prospect. However, these factors were not taken into account by HRDC and Fisheries and Oceans in forecasting the rate of participation.

16.35 According to an HRDC evaluation study, median income in the first complete year of TAGS (1995) was estimated at \$14,721; median annual income in the four years preceding the closure of the fisheries (1988–91) had been \$14,668.

16.36 A normal attrition rate determined by the eligibility formula and an annual abandonment rate of 10 percent were used to forecast the cost of income support. It was estimated that only 8,500 participants or 28 percent of the forecast population would remain in TAGS by



At the end of March 1997, the abandonment rate since the start of TAGS was 0.5 percent.

Complete, reliable data on the target population were not available.

Exhibit 16.6

1999. According to current data, there are 21,722 participants whose eligibility ends in 1999, or 54.2 percent of the eligible population.

16.37 The abandonment rate took into account those who would leave the program for reasons other than the termination of their eligibility or the selection of an exit option. However, it did not take into account the special circumstances that might create obstacles to labour adjustment. The geographical distribution of unemployment, with especially high rates in small isolated communities, was one of these obstacles. Another was the lack of alternative employment, as stressed by TAGS. At the end of March 1997, the abandonment rate since the start of TAGS was 0.5 percent.

16.38 The capacity reduction measures were expected to lower the number of TAGS participants by 5,400. Aside from the cost of the reduction measures, no other costs related to these participants were forecast. The cost of a one-year delay in capacity reduction was estimated

at \$85 million in transitional aid and \$80,000 per participant who remained eligible for TAGS throughout its duration. Licence buybacks took place only in October 1995 and August 1996, and led to a reduction of 478 groundfish licence holders. Only 333 fishers and crew members took early retirement.

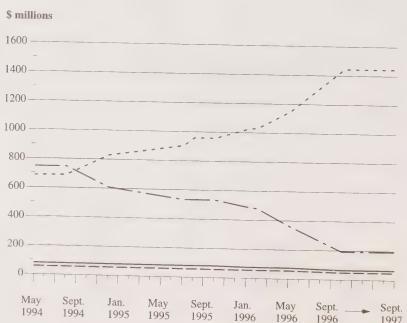
16.39 Complete, reliable data on the target population were not available. The respective impacts of various participation rates and sizes of the eligible population were not analyzed. The main factor emphasized was the additional cost per participant if an assumption proved to be inaccurate. Because of time constraints, alternative strategies were not considered even though it was recognized that the proposed strategy was based on assumptions that might not materialize.

16.40 Exhibit 16.6 shows the changes in funding available for labour adjustment. The present strategy no longer pursues the original HRDC objective of helping participants adjust out of the groundfish sector by preparing them for the labour market. In August 1996, two years after

Income support (including \$198 million transferred from DFO) Active participation measures Early retirement of plant workers Administration

Changes in the Funds Allocated

Source: Human Resources Development Canada



implementation, the strategy changed from active to passive participation.

16.41 In summary, the timetable to develop a strategy of the magnitude intended for TAGS was not long enough. The implementation date was chosen to maintain continuity with the former programs, particularly income support, and not to serve the objective of restructuring the fishing industry. When it came into effect, TAGS was not sufficiently developed for all stakeholders to adhere to its objectives and underlying concepts.

16.42 In contemplating any future initiatives of this magnitude, the government should ensure that departments have enough time to develop strategies that take into account completed analyses and possible options.

Department's response: While HRDC agrees that it is desirable for departments to have adequate time to develop such strategies so that complete analyses can be performed and possible options considered, and would have liked this to have existed for TAGS, the audit report does not note that there was an important urgency to get benefit payments to people who had lost their livelihood. This urgency warranted, in our view, the attempt to meet these objectives, imperfect as it may have been.

HRDC management responded to the implementation challenge

16.43 The difficulties encountered in the development of TAGS impacted on the management of its implementation. Management had to deal with heavy workloads to meet the needs of participants when key elements of the strategy were not yet available. Important constraints throughout implementation required from managers a considerable amount of flexibility and capability to adapt quickly to changing circumstances.

16.44 Setting up the systems to issue payments, process applications and assess eligibility were the main concerns of the staff involved in TAGS over the first 12 months. Numerous systems problems arose over the first few months, slowing down operations. There were overpayments and underpayments because of misinterpretations or systems errors. For example, differences in the income reporting periods between unemployment insurance and TAGS, as well as the lack of automatic reconciliation between the two systems, led to inaccuracies in payments.

16.45 In addition to systems that required strong analytical capabilities, there were complex eligibility procedures that were linked to employment in previous years and required an exhaustive database. HRDC had to make considerable efforts to make its systems usable for TAGS. This left little time for efforts directed to labour adjustment out of the industry.

16.46 The Department had planned, since the beginning, to use its Internal Audit Bureau (IAB) and program evaluation group to monitor the implementation of TAGS. The IAB produced a number of reports between October 1994 and May 1996, and their examination gave us a better picture of the nature and seriousness of the difficulties experienced since the April 1994 announcement of the Atlantic groundfish moratorium. These reports contained important observations and recommendations about the operational problems being encountered. Exhibit 16.7 shows some of these observations.

16.47 These reports resulted in some actions, mainly to improve computer systems and review beneficiaries' eligibility. They also highlighted the problems experienced by the regions,

which had to adjust to different policies and directives and even had to develop local policies to make up for the lack of general consensus. Consistency of action suffered because of this.

16.48 Without question, the major change the regions had to face was the abandonment of the policy of mandatory active participation by those eligible for assistance. The policy had been aimed at having participants assume responsibility for their situation by encouraging adjustment efforts to increase their chances of finding a job. Financial assistance was tied to active participation on the part of each participant.

16.49 Important regional differences were noted in the application of this policy. The Nova Scotia region, among others, stressed the adjustment program with its participants and strongly

encouraged them to join, going so far as to terminate benefits to individuals who refused to comply. Participants could thus receive different treatment, depending on the region where they lived and the local policies in place.

16.50 In November 1995, mandatory active participation of all participants was abandoned and replaced with a prioritization policy, which focussed efforts on the more motivated participants with greater potential for adjustment. Although some counsellors accepted the change, others simply felt betrayed. Counsellors' credibility was at stake—having firmly supported active participation, they now had to change direction. Finally, in August 1996, all adjustment measures were abandoned in order to keep the funds available for income support.

Exhibit 16.7

Internal Audit Observations – Human Resources Development Canada

Internal audit reports	Operational problems
Pre-implementation Review of the Atlantic Groundfish Strategy Computer System (October 1994)	Significant payment errors occurred in TAGS early stages due to system weaknesses.
Operational review of The Atlantic Groundfish Strategy (January 1995)	 Program objectives were difficult to achieve because of factors such as delays in implementation, attitudinal barriers and limited incentives to adjustment out of the fishery. Delays in implementation due to the lack of operational plans.
Impact Study Report – Analysis of TAGS Eligibility and Assessment Process (January 1996)	• A considerable error rate (Newfoundland 29.85%, other regions 35.48%) was noted in the calculation of eligibility duration for TAGS participants.
Operational review of The Atlantic Groundfish Strategy (February 1996)	 Frequent changes have reduced counsellors' credibility and made them more hesitant to respond to policy changes. The current level of income support payments is reported to be a disincentive to adjustment, because it is higher than the income from a minimum-wage job.

16.51 In summary, many operational difficulties arose during the implementation of TAGS, and HRDC reacted as the situation evolved.

Operational constraints changed the way TAGS evolved, sometimes resulting in a re-evaluation of objectives.

16.52 The government should ensure that any future strategy of this magnitude is launched in a systematic way, even if the intervention is temporary.

Department's response: While HRDC agrees that, to the extent possible, any strategy of this magnitude should be launched in a co-ordinated way, the audit report does not note that in this particular case, given the changing circumstances that this Department faced, it made every effort within its control to ensure that this was accomplished.

Operational Difficulties in Managing Eligibility

Difficulties in implementing eligibility criteria

16.53 Applying the eligibility criteria required co-operation between Human Resources Development Canada (HRDC) and Fisheries and Oceans Canada. HRDC was responsible for determining whether a worker had enough insurable weeks of work to qualify for TAGS, while Fisheries and Oceans was responsible for confirming workers' attachment to the groundfish industry (that is, determining designated plants and fisher status of workers).

16.54 Eligibility had two components:

- workers' eligibility based on their attachment to the labour force and the groundfish fishery; and
- the duration of the eligibility period, which could vary from two to five years.

16.55 The criteria for determining eligibility and duration of benefits were not easy to apply, because they were not based on the type of information that was available. The fact that eligibility depended on employment over the past five or six years made it essential to ensure from the outset that the necessary data existed and were available.

16.56 HRDC had no means of determining whether workers laid off by a designated plant really had an attachment to the groundfish fishery. It was assumed that anyone who had worked in a designated plant was dependent on the groundfish industry, regardless of the actual work done. This gave all workers from these plants access to the program, including individuals processing other species of fish or doing other types of work.

16.57 Fishers were entitled to benefits as long as it had been established that the volume of their groundfish catches and their income from them met TAGS criteria. In Newfoundland, however, Fisheries and Oceans did not keep records of catches for vessels smaller than 35 feet long. The information needed to assess the fisher status of these fishery workers was not readily available and this resulted in a lack of consistency in the handling of applications.

16.58 Fisheries and Oceans was in charge of assessing the nature of the operations of groundfish processing plants and granting them designated plant status according to previously established criteria. The list of designated plants was drawn up as workers applied to TAGS. There was no complete and official listing available at the time we did our audit. Situations were examined on a case-by-case basis, which allowed certain

Anyone who had worked in a designated plant was assumed to be dependent on the groundfish industry, regardless of the actual work done.

departures from the criteria on the grounds of extenuating circumstances.

Some plant owners would have preferred not to be given designated plant status for fear of losing their employees, whereas workers called for it so they could be eligible for TAGS. To be eligible, plant workers had to have been laid off by a designated plant, but it was difficult to distinguish between layoffs caused by the groundfish moratorium and the seasonal layoffs that occur widely in the industry. Layoffs were verified against information from records of employment for the referenced years. In examining the employment records of a number of participants, we found that for the past four or five years the majority of them had been laid off every year in the same way and at the same period.

The eligibility criteria applied by HRDC required an assessment of labour force attachment for each calendar year. The basic documents used for this were records of employment. However, these documents had not been intended to be used for determining the number of insurable weeks per calendar year — they were normally used to establish entitlement to unemployment insurance benefits based on the work history in the 52 weeks of work preceding the layoff. Therefore, in many cases HRDC could not determine from the record of employment the number of insurable weeks for the year in question.

16.61 In summary, implementation of the eligibility criteria entailed several difficulties. The information available for assessing the eligibility of groundfish workers did not always correspond clearly to TAGS eligibility criteria. Therefore, decisions that might have had an impact on applicants' rights to benefits were made on the basis of incomplete information.

16.62 The government should ensure, before they are implemented, that the eligibility criteria set out in any similar strategy are clear, logical and applicable.

Department's response: HRDC agrees that eligibility criteria set out in a strategy should be clear, logical and applicable before being implemented.

Complex process to determine the eligibility period

16.63 In its report of January 1996, entitled Impact Study Report — Analysis of TAGS Eligibility and Assessment Process, the HRDC Internal Audit Bureau focussed on the issue of eligibility and reported very high error rates in the calculation of the duration of eligibility (29.85 percent in the Newfoundland region and 35.48 percent in the Prince Edward Island, Quebec, New Brunswick and Nova Scotia regions). As a result of this report, the Newfoundland, Nova Scotia and Prince Edward Island regions joined forces and set up a special unit known as DARE (Duration Review Assessment Exercise) to review participants' eligibility for TAGS. By April 1997, a total of 12,214 files had been reviewed and an error rate of 29 percent in the calculation of duration had been confirmed.

16.64 It is now the fourth, and perhaps final, year of TAGS. Eligibility is still a subject of interest, because the funds devoted to income support are directly linked to the duration of eligibility. We examined the current situation to determine whether corrective measures have been taken and whether only eligible individuals are receiving or have received benefits.

16.65 We took regional differences in the management of eligibility into account in selecting a sample of files for audit. We

The information available for assessing the eligibility of groundfish workers did not always correspond clearly to TAGS eligibility criteria.

selected a sample of 100 files from the participant population in Newfoundland, Nova Scotia and Prince Edward Island (these regions have already systematically reviewed many of their files). Another sample of 100 files was drawn from the Quebec and New Brunswick population, where corrective measures taken differed. The audit consisted of a review of eligibility criteria (benefit entitlement and duration of eligibility) applied by each of the two participating departments. Exhibit 16.8 shows the results of this audit.

16.66 The errors detected in the application of HRDC's eligibility criteria primarily involved the duration of benefits and resulted in overpayments and underpayments. The duration of eligibility was not assessed in accordance with operational guidelines. Therefore, payments have been or probably will be made to participants whose eligibility for the period in question has not been correctly assessed. The errors detected in the application of DFO's eligibility criteria cast doubts on the eligibility of participants, because their attachment to the fishing industry was not proved. However, the number of errors detected was small.

16.67 The results of our audit of the criteria applied by HRDC confirm the value of the work done by the DARE unit in Newfoundland, Nova Scotia and Prince Edward Island. These regions have substantially improved the quality of their eligibility decisions, while the Quebec and New Brunswick regions still have very high error rates. The different regions have not placed the same emphasis on managing eligibility, and participants have therefore not been treated in the same way from one area to another.

16.68 The guidelines were not clear enough to ensure uniform interpretation of the eligibility criteria. Files had to be reviewed several times, and successive notices were sent to participants informing them of changes to their eligibility periods. After more than three years of operation, there are still many inaccuracies in the files.

16.69 Overpayments detected in these reviews were generally due to administrative errors, and the policy was not to claim reimbursements from beneficiaries. Beneficiaries were even given an eight-week grace period before TAGS payments were terminated.

16.70 Major regional differences in the interpretation or application of eligibility

Payments have been or probably will be made to participants whose eligibility for the period in question has not been correctly assessed.

The guidelines were not clear enough to ensure uniform interpretation of the eligibility criteria.

Exhibit 16.8

Participants File Review - The Atlantic Groundfish Strategy Eligibility Audit

	Population	Number of files selected	Samples with errors according to criteria of		Percentage of files with
Regions			HRDC	DFO	errors
Newfoundland Nova Scotia Prince Edward Island	35,258	100	6	3	9
Quebec New Brunswick	3,543	100	36	2	38

A single indicator, adjustment out of the groundfish fishing industry, was used to measure results. criteria were noted in our review. When a participant works in a designated region affected by severe catch failure, the two worst years can be omitted for the purposes of calculating the duration of eligibility under TAGS. The Lower North Shore region used this provision to calculate its clients' benefits, while other areas also affected by severe catch failure did not.

16.71 Verification of fisher status for plant workers who also fished full time during the first years covered by TAGS was not done in the same manner for all participants. In the Quebec region, contrary to Newfoundland, insurable weeks from those years were accepted as groundfish fishing weeks without confirmation of the participant's fisher status.

16.72 Records of employment were not always used properly for determining the number of insurable weeks to establish duration of eligibility. In some cases, staff made decisions without having obtained all the necessary information. Review of employment records and a better analysis of the facts using other documents that were available might, in many cases, have produced a better assessment of the applications.

16.73 In summary, eligibility review was a problem that was recognized from the start and that required considerable effort from staff and management. The different interpretations and approaches to reviewing information resulted in major differences in the assessment of eligibility. Certainly, participants were not informed in a timely way of their duration of eligibility. It is difficult to conduct thorough counselling sessions in the absence of information pertaining to the duration of participants' entitlement to the Strategy. The difficulties encountered during eligibility assessment required far

too much effort, time and energy for the process to be considered efficient.

16.74 The Department should:

- ensure that the review undertaken by the Newfoundland, Nova Scotia and Prince Edward Island regions is completed as soon as possible; and
- consider whether the review should be extended to all TAGS participants.

Department's response: The reassessment of the files for Newfoundland, Nova Scotia and Prince Edward Island will be completed by early fall. HRDC is proceeding to reassess the files from New Brunswick and Quebec to ensure that clients are treated in the same way from one region to another and receive their correct entitlement to TAGS income support benefits.

The Results of Labour Adjustment Will Not Be Known

16.75 Human Resources Development Canada's objective for labour adjustment was to support clients in their adjustment out of the groundfish fishing industry. The Department did set a goal to adjust 50 percent of the clientele eligible for TAGS. Progress toward the target was measured on an ongoing basis. Successful adjustment was measured in terms of the total number of participants who were no longer dependent on TAGS income support because they had become self-sufficient outside the groundfish industry, with or without one of the forms of assistance provided by TAGS.

16.76 A single indicator, adjustment out of the groundfish fishing industry, was used to measure results. A first target of 25,000 participants was established for the global measurement of TAGS adjustment interventions, whether by HRDC or Fisheries and Oceans. A second target of 7,500 participants was set to measure the results of interventions attributable to

HRDC, based on the clientele targeted for active participation having been established at 15,000 participants. When it became necessary to transfer funds to income support from other TAGS adjustment measures, the target of 7,500 participants was reduced to 5,500, and ultimately abandoned.

16.77 The Department used the following method to estimate adjustment on an ongoing basis. The number of participants who had made a successful adjustment was calculated on the basis of data from the TAGS payment system, and included participants who had received less than 25 percent of the benefits payable during a 12-week period. For those participants who had adjusted out as a result of HRDC interventions such as the Employment Bonus, Wage Subsidy, Self-Employment Assistance and Job Opportunities, the adjusted-out figure was discounted by 35 percent. This adjustment was based on past success rates in similar programs achieved in the regions affected by TAGS.

16.78 The reliability of this method has not been established. A participant survey would be needed to determine the confidence level or to review the adjustment factor. The Department recognizes that follow-ups or evaluations are necessary, but there is no plan to conduct any.

16.79 The Department had to evaluate a five-year program that was recognized as having by necessity been developed too quickly. Two types of evaluation had been planned. The first, to be conducted during the program's development and implementation, was to recommend improvements to the program. The Department requested and obtained the appropriate evaluation studies and a first evaluation was completed. The studies for

this evaluation dealt with issues that were appropriate and useful for management purposes. The second type of evaluation was to have been conducted once the program had stabilized, and was intended to evaluate the results and effects of the program. However, because of the way TAGS developed, evaluation efforts were abandoned in March 1997. The second type of evaluation will not be done and many questions will remain unanswered.

Important questions that the second evaluation would have raised included: "Does income support encourage or limit effective adjustment for TAGS clients? To what extent has TAGS contributed to an orderly transition to employment outside the fisheries sector?" With the abandonment of evaluation efforts, there will be no clear answers to these questions. It will not be possible to draw useful lessons for future programs. Information to account for the money spent will not be available, and it will not be possible to determine the extent to which TAGS objectives were achieved. We are concerned that the information gathered in the initial phase and the lessons learned might be lost and the results remain unknown.

16.81 The Government of Canada recently announced that it would make a temporary change to the Employment Insurance Regulations allowing TAGS benefits to be considered as labour force attachment for the purpose of qualifying for employment insurance benefits. It also announced its commitment to undertaking a review of longer-term post-TAGS issues in the fall and to consult with relevant provinces and industry stakeholders.

16.82 The Department should continue its efforts to evaluate the TAGS labour adjustment component and report on the results, thus contributing to an enlightened

Information to account for the money spent will not be available.

The reliability of the method used to measure results on an ongoing basis has not been established.

> discussion of all programs of this type that may be considered in the future.

Department's response: HRDC agrees in principle that efforts to evaluate the TAGS labour adjustment component and to report on the results should be continued. However, as the labour adjustment component of TAGS is no longer available, other than that of income support, any evaluation conducted of TAGS would have to be done as part of HRDC's regular evaluation of programs. The Department has already learned useful lessons from TAGS and will continue to access results through its regular activities.

An Accountability Framework Unsuited to the Strategy

16.83 The Atlantic Groundfish Strategy was the fourth program to target problems associated with the decline of Atlantic groundfish (see Chapter 14, Exhibit 14.12). Two of the three programs that preceded it also included components aimed at industry capacity reduction and labour adjustment. Therefore, we expected to find that an effective accountability structure had been put in place for TAGS.

16.84 Before TAGS came into force, the Treasury Board informed Fisheries and Oceans and Human Resources
Development Canada that it was holding them equally responsible for managing TAGS within the financial envelope provided. It mandated HRDC to set up a control system to ensure that costs did not exceed the envelope. HRDC assumed a lead role and devoted time and efforts to ensure that the financial constraint imposed on TAGS was respected.

16.85 The responsibilities of the organizations charged with developing and implementing TAGS were not clearly defined and agreed upon in a memorandum of understanding. There

was no formal mechanism for co-ordinating activities. Co-ordinating was important and the need for extensive mechanisms to do so should have been envisaged. Overall, co-ordination was informal. Human Resources Development Canada recognized that TAGS required joint administration on the part of the organizations concerned, and tried to provide co-ordination by inviting its federal partners to participate in its TAGS management team. However, its authority to do so was not recognized and its efforts sometimes irritated its partners.

16.86 While the implementation of the TAGS components generally corresponded to the responsibilities of the participating departments, a number of initiatives were complementary and required co-operation and an exchange of information. Examples are the determination of TAGS eligibility and the identification of a core group of fishers. At the regional level, there were certain memorandums of understanding between HRDC and Fisheries and Oceans for projects or the exchange of information.

16.87 According to the guiding principles approved for it, TAGS was to offer an integrated approach to capacity reduction and the adjustment of individuals and communities affected by the moratorium. It was essential that management and accountability be integrated as well.

16.88 However, there was no integrated strategic plan to identify and schedule the activities of the organizations responsible for implementing TAGS or to determine the performance indicators to be used, monitored and reported on periodically. Although certain activities were conducted jointly, each organization conducted its own audit and evaluation activities and the results were not consolidated.

Overall, co-ordination was informal.

There was no integrated strategic plan to identify and schedule the activities of the organizations responsible for implementing TAGS.

16.89 Given that co-operation among the four organizations responsible for implementing TAGS was so important to its success, we expected that Parliament would receive integrated information to account for the use of funds. However, no joint report was issued by the four organizations.

16.90 There is information on some TAGS components in the Part III Estimates of Fisheries and Oceans and of Human Resources Development Canada. Both departments also testified several times before the Standing Committee on Fisheries and Oceans on the implementation and progress of TAGS. However, none of this made it possible to determine progress toward the TAGS objective of restructuring the fishing industry to make it economically viable and environmentally sustainable.

16.91 In summary, our review of the accountability framework for TAGS revealed major weaknesses that had an impact on value for money. Great care in planning a strategy of this magnitude was needed to ensure that its objectives were reached. Because a number of stakeholders were involved and their activities were often joint or complementary, the different components needed to be carefully co-ordinated. The forecasts used to distribute program funds among the stakeholders were based on a strategy different from the one ultimately approved. Despite numerous consultations, the stakeholders did not necessarily have the same timetable. The co-ordination framework was inadequate.

16.92 Should another strategy be adopted that involves a number of federal organizations, the government should consider instituting formal measures to ensure accountability for the strategy as a whole.

Department's response: HRDC agrees that should another strategy be adopted that involves a number of federal organizations, formal measures to ensure accountability for the strategy as a whole should be in place. The accountability framework now in place for Employment Insurance Part II reflects HRDC's commitment to this principle.

Conclusion

16.93 After numerous efforts and successive programs and activities to support the population affected by moratoriums and reduced groundfish quotas, the necessity and viability of such actions need to be examined.

At a time of dramatic change in the Atlantic fishing industry, TAGS was designed to carry on the previous efforts to support workers in the industry. The income support and labour adjustment programs supporting TAGS changed continually as the various elements of TAGS fell into place. Uncertainty remains about whether TAGS is primarily an income support program or an industry restructuring program. Although active labour adjustment measures had been designed to support industry restructuring efforts, the co-ordination and scheduling of TAGS activities did not make it possible to maintain them. The abandonment of all labour adjustment measures in August 1996 has left only the income support component still in place.

16.95 The frequent changes to TAGS made it difficult to implement the labour adjustment measures. These changes created considerable uncertainty among participants and stakeholders. The operational guidelines underwent numerous changes and clarifications.

Management of eligibility was particularly affected, resulting in many situations

Uncertainty remains about whether TAGS is primarily an income support program or an industry restructuring program.

Whether active labour adjustment measures actually contributed to reducing the number of persons dependent on the industry is not known.

where income support was not assigned fairly and equitably to all participants.

16.96 Progress toward the target for labour adjustment will not be measured by HRDC. Although an evaluation aimed at improving the program was carried out, the decision to discontinue the evaluation effort means that important questions will remain unanswered, and it will not be possible to learn all the lessons that might have been drawn from the experience or to account for the results.

16.97 The absence of an appropriate accountability framework for this type of initiative meant that there was no assurance of obtaining value for money. Efforts were directed at income support for individuals affected by the groundfish

moratorium; groundfish harvesting capacity was not significantly reduced through TAGS measures. Active labour adjustment measures were halted, and whether they actually contributed to reducing the number of persons dependent on the industry is not known. Excess fishing capacity remains, and poses a major risk to the sustainability of the fishing industry.

16.98 Given that the federal government proposes to review the longer-term issues arising from the elimination of TAGS in May 1998, we urge it to examine carefully the consequences and impacts of the decisions made under TAGS in order to benefit from the valuable lessons that can be learned.



About the Audit

Objective

The objectives of this audit were to determine whether, for the purposes of The Atlantic Groundfish Strategy:

- the income support and labour adjustment programs administered by Human Resources Development Canada contributed to the economical and efficient achievement of objectives;
- an effective accountability framework was established.

Scope

Our audit covered the measures established by Fisheries and Oceans and Human Resources Development Canada to account for the delivery of The Atlantic Groundfish Strategy. The labour adjustment component administered by Human Resources Development Canada was examined in relation to TAGS objectives.

We reviewed the planning and implementation documents describing the different stages in the evolution of TAGS. We examined how HRDC performed its internal audit and evaluation duties, in particular the recent work on TAGS. Participant eligibility and entitlement to benefits were covered by reviewing eligibility criteria applied to a sample of TAGS participant files.

The management of active labour adjustment measures was not audited because, at the time of our audit, they had been discontinued. Our audit did not deal with the use of funds allocated to the Atlantic Canada Opportunities Agency and the Federal Bureau of Regional Development – Quebec.

Criteria

The criteria used in our audit were the following:

- The planning and implementation of income support and labour adjustment programs administered by HRDC should reflect government objectives and be designed to carry out the objectives of The Atlantic Groundfish Strategy.
- The results of HRDC activities related to TAGS should be measured and known.
- The Department should provide Parliament with reliable, relevant, and comprehensible information.
- The Department should ensure that all those and only those who are eligible receive income support.
- An accountability structure should be put in place for The Atlantic Groundfish Strategy.

Audit Team

Andrée Bélair Kathleen Hobbs Sylvie Paré Michael Ryan

For information, please contact Louis Lalonde, the responsible auditor.



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Report of the Auditor General of Canada to the House of Commons

Chapter 17

Human Resources Development Canada – A Critical Transition toward Results-Based Management



Report of the Auditor General of Canada to the House of Commons

Chapter 17

Human Resources Development Canada – A Critical Transition toward Results-Based Management

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Chapter 17

Human Resources Development Canada

A Critical Transition toward Results-Based Management The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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Assistant Auditor General: David Rattray Responsible Auditor: Louis Lalonde

Human Resources Development Canada

A Critical Transition toward Results-Based Management

Main Points

- 17.1 Human Resources Development Canada has begun a transition toward results-based management. To this end, it has instituted a number of initiatives, including the publication of its *Results-Based Accountability*Framework, consultation with employees, and establishment of performance measures for major activities. The Department has also extended the application of these performance measures to activities carried out jointly with its partners. Overall, the roles and responsibilities of the partners are well defined. Also, the new Labour Market Development Agreements generally include the elements that are essential to good accountability among partners.
- 17.2 Certain steps remain to be taken to complete this transition. The Department needs to strike a suitable balance among the effectiveness, cost and quality of its services; at present, it does not analyze costs along with key performance indicators. It also needs to link performance to the consequences of having met or not met expectations.
- 17.3 The support of the employees working in the Human Resource Centres of Canada is essential if the Department is to successfully implement the Framework. The credibility of data on certain programs needs to be resolved within a reasonable timeframe. Employees need to have confidence in the reliability of the information, or the entire initiative may be jeopardized.
- 17.4 The information that Parliament receives on actual results compared with stated objectives is incomplete. We believe that, given the importance and the special nature of the Employment Insurance Account, it would be beneficial for Parliament if information were all in one place. There is no distinct report containing financial information on performance. Such a report could include, among other things, performance information, results achieved and actuarial analyses, which at present are not tabled in Parliament. Tabling actuarial analyses would improve the transparency and the availability of the data necessary for establishing an adequate reserve in the Account.
- 17.5 Our audit of two activities, management of accounts receivable and protection of program integrity, confirmed that progress has been made in results-based management. The Department has made major efforts since 1994 to integrate and harmonize the management of accounts receivable for all its programs. However, the quality of the portfolio of accounts receivable has deteriorated over the last five years. The performance of accounts receivable could be better measured, targeted and analyzed in order to assess the cost effectiveness of the Department's collection activities.
- 17.6 In activities for the protection of program integrity, results-based management is most advanced in the Employment Insurance Program. Since 1992, the Investigation and Control Directorate has been using information on results to negotiate resource levels and to set the national savings expectation. However, the other activities for the protection of public funds could be better measured and targeted in order to manage for results.



Introduction

The Department is going through a transition

17.7 Recent years have seen a trend, both in the federal government and elsewhere, toward increased management accountability. A number of related initiatives have been undertaken at the federal level: Public Service 2000, Program Review, increased flexibility in human resource management, the requirement for Business Plans, and an emphasis on managing for results.

17.8 Human Resources Development Canada (HRDC) provides services in various areas such as employment insurance, income security and student loans. In 1996–97 the Department made disbursements totalling \$56 billion, including payments for the Employment Insurance Account and the Canada Pension Plan. Some seven million Canadians received benefits or other forms of assistance.

17.9 The Department has begun a transition toward results-based management, whose underlying philosophy involves a change from the traditional emphasis on process to one that focusses on results. In practical terms, this means that managers will be more and more responsible because of increased authority and more flexible rules. This is expected to produce more effective accountability with an emphasis on results achieved.

17.10 To complete this transition, HRDC is working on a number of fronts simultaneously: the Service Delivery Network, the Income Security Programs Redesign Project, the *Employment Insurance Act*, the review of the *Canada Labour Code*, agreements on alternative service delivery, and Labour Market

Development Agreements with the provinces.

17.11 In October 1996 the Department published its Results-Based Accountability Framework, setting out the main elements of its new management philosophy. Exhibit 17.1 provides a schematic summary of one of the major elements of the Framework — results-based management. The Department has also published a document entitled Redefining Our Roles and Responsibilities in Support of Departmental Priorities, which defines in general terms the roles and responsibilities of the Department's Corporate Service. The document Quality Services Journey deals with the Department's approach to the government's Quality Service initiative. All of these documents are interrelated.

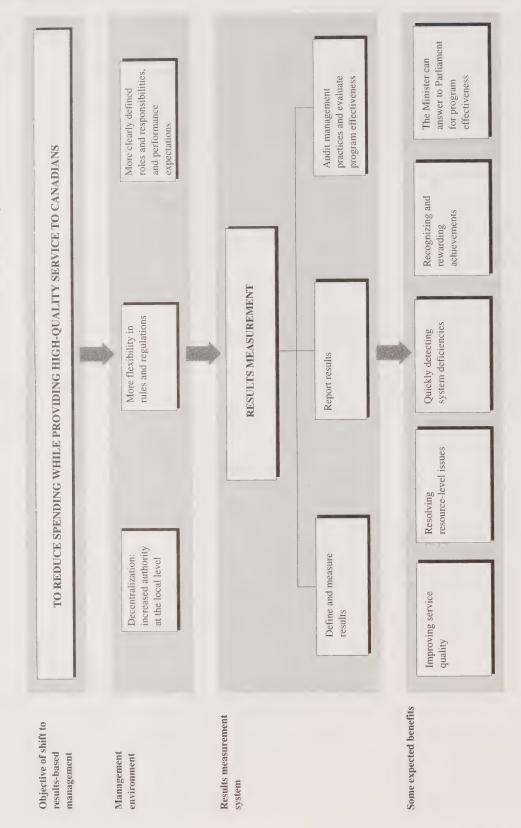
Focus of the audit

17.12 The objective of our audit was to examine one of the major elements of the *Results-Based Accountability Framework*, namely results-based management. Since HRDC has an important place in the federal government, we thought it would be appropriate to examine the progress it has made and the steps it still needs to take. We looked at progress in two specific activities: management of accounts receivable and protection of program integrity. Findings on these two activities are presented in the two cases that begin at paragraph 17.67.

17.13 We also examined the information the Department provides to Parliament, including information on results. For this, we selected the Department's two largest programs: the Canada Pension Plan and the Employment Insurance Account. Further details on the audit objectives, scope and criteria are presented at the end of the chapter, in the section entitled About the Audit.

Results-based management involves a change from the traditional emphasis on process to one that focusses on results.

Schematic Summary of Results-Based Management at HRDC



Source: Data obtained from the Results-Based Accountability Framework, Human Resources Development Canada (HRDC), October 1996

Observations and Recommendations

Progress toward Results-Based Management

Employee support and senior management participation are essential

Implementing results-based management is always a major challenge, since it involves changing a complex set of elements and dimensions that underlie existing management structures. It is important to first clearly define the nature of the change to be made and to specify its main parameters. The Department did this when it published its Results-Based Accountability Framework in October 1996, which describes the planned changes to the Department's management approach. Although this framework is recent, we were able to identify a certain amount of progress achieved in the past year.

17.15 A precondition for the success of an initiative aimed at changing a management approach is that it be clearly formulated and accurately reflect the Department's mission and operating principles. We found that the Framework does both. In examining the strategic planning documents (HRDC Business Plan Summary, Estimates, Quality Service Strategy), we noted that they are interrelated and are consistent in terms of their objectives and the methods to achieve them.

17.16 Another requirement for successfully implementing a new management framework is employee support. The Framework stresses the importance of consulting with employees, and the Department is making efforts to do so. It sent a questionnaire to employees in certain Human Resource Centres of

Canada and held a series of discussion groups in five regions. These consultations revealed that employees were reticent about some aspects of the initiative. Given the importance of securing their participation, the Department is continuing discussions to address employees' concerns.

The active participation of senior management is also a decisive factor in the success of results-based management. We noted that HRDC established a steering committee on quality of service, made up of assistant deputy ministers, which has met regularly since September 1995 to discuss progress in implementing the service quality and results-based management initiatives. It has made various decisions aimed at ensuring that the pace of progress is satisfactory. The Department's Management Board has also monitored progress and discussed the implementation of the new management approach and the related performance reports that have been issued.

17.18 The Department has increased its delegation of authority and has shown more flexibility at the local level. It has begun implementing the Service Delivery Network, aimed at making it easier for clients to access various HRDC services while achieving savings in the use of resources. One of the objectives of this initiative is to increase the authority, empowerment and accountability of line staff. Income Security Programs is also introducing a new client service delivery network, which will broaden the responsibilities of employees at the local level.

17.19 The Department publishes reports on its efforts to reduce obstacles, that is, practices that burden and slow down management unnecessarily and deprive employees of the needed flexibility to

The Department recognizes the importance of consulting with employees and is making efforts to do so.

Exhibit 17.2

Roles and Responsibilities - Employment Insurance 1997

Elements	Parliament	Governor in Council	Treasury Board	HRDC Department	Canada Employment Insurance Commission	National Revenue	Department of Finance
Acts and amendments	Approves			Prepares			
Regulations		Approves			Prepares		
Plans and budgets Business Plan and budget plan Plan on estimates of employment benefits and support measures Major projects Premium rates Insurable earnings	Receives	Approves Approves	Approves Approves	Prepares Prepares Prepares Recommends Recommends	Sets Sets		Recommends Recommends
Administration Collection of premiums Insurability of employment Insurance and employment service				Responsible		Responsible Responsible	
Report Annual financial report Report on monitoring and assessment of the Employment Insurance Act Report on performance	Receives ¹ Receives ³ Receives ²			Prepares Receives Prepares	Prepares		
Appointment Commissioners Umpires Members of Boards of Referees Presidents of Boards of Referees		Appoints Appoints			Appoints		

¹ Using Volume I of the Public Accounts

HRDC

HRDC provides insurance and employment services, as well as corporate services, at Human Resource Centres of Canada.

It is responsible for the labour market adjustment, job-related training and employment insurance programs.

It is also responsible for the human resources assigned to these services and programs.

Canada Employment Insurance Commission

The Commission is a model of tripartite management by the government, workers and employers. It comprises four commissioners appointed by the Governor in Council. The Deputy Minister and the Assistant Deputy Minister of the Department are the Chairperson and Vice-Chairperson respectively of the Commission. The Vice-Chairperson is not entitled to participate in discussions and votes unless he/she is replacing or representing the Chairperson. The other two commissioners represent workers and employers respectively, and are appointed following consultations with organizations representing those groups.

Other stakeholders

HRDC and Revenue Canada have a Memorandum of Understanding (MOU) setting out the roles and responsibilities of each. This MOU was revised in June 1994. As can be seen from the chart above, the Department of Finance, Treasury Board and the Governor in Council also have certain roles to play in administering the program. Pursuant to Labour Market Arrangements, some provinces will assume responsibilities for employment services.

Source: Information obtained from Human Resources Development Canada

² Using Part III of the Estimates

³ Report on assessment of the impact of implementation of this Act and on the effectiveness of employment benefits and other assistance provided

Exhibit 17.3

Administrative Structure
Canada Pension Plan 1997

Minister of Public Works

and Government Services

Canada

Minister of Human Resources Development Canada Minister of Revenue Canada Minister of Finance

Canada Pension Plan Advisory Board

- reviews, from time to time or as it deems appropriate or advisable, the operation of the Act, the state of the CPP Investment Fund and the adequacy of the coverage and benefits under the CPP Act.
- prepares an annual report to the Minister on its activities

Human Resources Development Canada

- provides clients with information, advice and counselling about CPP
- determines eligibility for, and approval of benefits
- maintains records and accounts with supporting systems
- provides contributors with information on their earnings, contributions and projected benefits
- manages an appeals process on benefit eligibility
- assigns social insurance numbers to individuals and maintains the Central Index of those numbers
- negotiates and administers International Social Security Agreements
- detects overpayments and manages accounts receivable

Revenue Canada

Parliament

- administers the collection of contributions
- provides rulings regarding CPP coverage and contribution requirements
- provides contributor information to the CPP
- reconciles T-4s and investigates any discrepancies
- maintains records for remittances, assessments and deposit funds
- manages an appeals process on contribution related matters
- provides system and administrative support

Department of Finance

- sets CPP contribution rates in consultation with the provinces and territories
- manages the CPP Investment Fund by investing excess monies in the CPP in securities of provincial and territorial governments, provincial Crown agencies, or the Government of Canada

Public Works and Government Services Canada

- issues payment to CPP clients
- develops, maintains and operates supporting information systems to process information on contributor earnings, benefit payments, and program statistics
- provides accommodation and property management

Office of the Superintendent of Financial Institutions

The Chief Actuary:

- prepares the Actuarial Reports for tabling in Parliament on the projected financial status of the CPP Account for the next 75 years
- prepares actuarial estimates on proposed changes to the Plan's provisions when requested and approved by HRDC
- calculates the effects on the CPP Account of proposed amendments to the CPP once a Bill has been introduced, in accordance with a request received from HRDC

Memoranda of Understanding:

In order to clarify the roles and responsibilities of each of the departments, Memoranda of Understanding (MOUs) between CPP and the following departments were signed:

- Revenue Canada November 1996
- · Revenue Canada (Record of Earnings) February 1992
- HRDC Income Security Programs Branch December 1996
- HRDC Social Insurance Number August 1990
- HRDC Corporate Services February 1996
- Public Works and Government Services Canada September 1990
- Office of the Superintendent for Financial Institutions March 1996

These MOUs clarify the roles and responsibilities of each department. They set out the roles and responsibilities and reporting relationships between the respective parties. They list the services to be provided, budgets and costing principles as approved by Treasury Board. They also spell out the billing arrangements, the timing of the audit and by whom. There are provisions for potential special studies. Furthermore, performance information is requested from the departments and some of that information is published in the Annual Report of the CPP for 1995-96.

Source: Information obtained from Human Resources Development Canada

resolve problems quickly and effectively. The Department points to a number of administrative changes that simplify the approval process and increase the authority delegated to the local level.

Roles and responsibilities of partners are generally well defined

17.20 In the context of results-based management, with flexible rules and more delegated authority, the responsibilities of each of the stakeholders need to be set out clearly. The parties need to have a clear idea of what they are being held responsible for and what results they are expected to achieve. We examined the Employment Insurance Account and the Canada Pension Plan (CPP), whose administration is the responsibility of a number of federal partners, to determine whether the roles and responsibilities of each are clearly defined.

17.21 In our opinion, the roles and responsibilities of the various federal partners who administer the Employment Insurance program (see Exhibit 17.2) are, overall, well defined. There is a Memorandum of Understanding between HRDC and Revenue Canada setting out their respective roles and responsibilities, which was revised in June 1994. While the role of the Canada Employment Insurance Commission is clear, it is somewhat limited and should not be compared with the traditional role of a board of directors.

17.22 The CPP is also administered and operated by various federal partners (see Exhibit 17.3), making it more difficult to plan and manage the program and to define the respective responsibilities of the various departments. Memorandums of understanding have been negotiated and signed by the various parties involved, clarifying the roles and responsibilities of each. We nevertheless have some

concerns about some aspects of the Chief Actuary's role and responsibilities.

In accordance with the CPP Act, 17.23 the Chief Actuary of the Office of the Superintendent of Financial Institutions prepares actuarial reports on the projected status of the CPP Account for the next 75 years. These reports are transmitted to the Minister of Finance who tables them before Parliament. In connection with our audit of CPP Disability benefits last year, we examined the assumptions made for financial forecasts by the Chief Actuary in his Fifteenth Actuarial Report as at December 31, 1993 (the most recent one published) and found them to be adequate and appropriate. However, we believe the Chief Actuary's role and responsibilities in relation to the provinces need to be clarified.

17.24 The federal and provincial governments, as partners in the decision-making process, can call upon the Chief Actuary's services to analyze the potential impact of any proposed changes to the Plan. We expected that his analyses would be available to all partners on a timely basis.

The Chief Actuary informs the Department of Finance of any requests he receives from the provinces, without disclosing their content. He has assured us that the results of his analyses go directly to the requesting province and that all results remain confidential. The Chief Actuary does not report to the provinces similar requests by the federal government. We believe that all analyses produced should be made available to all the partners. It is important that the Chief Actuary's role and responsibilities be clarified to ensure that all partners have access to the same information. This would add transparency to the decision-making process.

It is important that the Chief Actuary's role and responsibilities be clarified to ensure that all partners in the Canada Pension Plan have access to the same information.

A system for measuring results has been put in place

17.26 The central element of results-based management is the measurement of results, which constitutes a systematic approach for attesting to the Department's performance. Program managers have established a maximum of three key performance indicators for

which Human Resource Centres of Canada will be responsible, and which will be used for measuring and reporting results to senior management and to Parliament. Exhibit 17.4 summarizes the key indicators selected for each business line. Secondary indicators of performance are used in monitoring activities.

17.27 By concentrating on a limited number of performance indicators, the

Exhibit 17.4

Key Performance Measures Defined by HRDC

	DIMENSIONS OF PERFORMANCE			
PERFORMANCE MEASURES	Quality of Service	Efficiency ¹	Effectiveness	
Insurance			***************************************	
Percentage of claimants issued their first cheque as soon as legally possible (that is, within 28 days of application)	=			
Percentage of Employment Insurance benefits paid in error				
Investigation and Control – Total savings				
Human Resources Investment Fund (HRIF)				
Number of clients employed or self-employed				
Current savings on Employment Insurance benefits resulting from returns to work earlier than expected because of HRIF intervention			-	
Labour				
Percentage of unjust dismissal complaints settled by inspectors				
Percentage of Part III complaints (other than unjust dismissal cases) resolved within 120 days				
Percentage of Part II non-compliance situations (excluding situations of danger) voluntarily resolved through acceptance of Assurances of Voluntary Compliance				
Income Security				
Percentage of telephone calls answered				
Speed of service for Old Age Security application processing				
Speed of service for Canada Pension Plan application processing				

¹ Efficiency is being tracked through secondary performance measures.

Source: Information obtained from Human Resources Development Canada, January 1997

Limiting the number of indicators allows the Department to focus its attention and efforts on priority aspects of performance.

Department is better able to ensure that managers and employees focus their attention and efforts on priority aspects of performance. HRDC produces regular performance reports, which are the subject of discussion and follow-up by departmental senior management. It has also begun setting up a Corporate Management System (CMS), an automated system to integrate and streamline the processing of information. This system will make it easier to produce the performance reports that are essential to results-based management.

In a context of increased co-operation among various levels of government, HRDC has not limited this new approach to its own activities but has extended it to joint activities with its partners. For example, the Department has signed Labour Market Development Agreements with a number of provinces. These agreements stem from the federal proposal to establish a new partnership with provincial and territorial governments in connection with labour market activities, based on the new Employment Insurance Act. These new arrangements aim to help put unemployed Canadians back to work, to encourage innovation and adoption of tested practices, and to strengthen federal-provincial-territorial partnerships.

17.29 The agreements generally include the elements essential to good accountability between partners. More specifically, they specify indicators for measuring results as well as targets for the results that are expected. The Department will use these same indicators to fulfil its obligations for monitoring and assessment. The indicators are: priority access for Employment Insurance claimants; the number of Employment Insurance clients who have returned to work; and savings in the Employment

Insurance Account achieved as a result of reduced dependency on Employment Insurance benefits.

17.30 However, it is important that this performance information not be simply filed away but be put to good use by program managers. Hence, the Department's Investigation and Control Directorate, whose objective is to prevent, detect and deter fraud and abuse in the Employment Insurance Account, has decided to use the total savings generated by its activities as a key performance indicator. Adoption of this indicator has had a marked impact on the nature and scope of investigation and control activities, by encouraging managers to seek an appropriate balance between prevention and detection. The indicator has become an element used to determine the level of resources to be allocated to the program and to facilitate accountability. More details on this subject can be found in Chapter 11, Moving toward Managing for Results.

Certain Steps Remain to Achieve Stated Objectives

Balance in indicators is important

17.31 The Department has decided to focus on a few key indicators so that senior management and employees can concentrate on the strategic results that are expected, instead of being overwhelmed by an excessive amount of information. Focussing on a few indicators is thus a positive step.

17.32 An important factor in choosing key indicators is the reasonable expectations of clients since, as the Framework notes, they are "best equipped to comment on what constitutes good service". Thus, Employment Insurance based its choice of some indicators on client surveys that showed which aspects

of service were most important to clients. Income Security Programs also plans to eventually include client satisfaction in its indicators.

17.33 The choice of the key indicators is of paramount importance, as they will serve as the guideposts for determining the quality of program and service management. Choosing performance indicators entails some risk, since the focus on highly specific indicators can affect other aspects of performance not considered as high a priority. Exhibit 17.4 shows the key performance measures chosen by the Department, based primarily on performance issues. For example, issues of telephone centre performance are much more pronounced in Income Security Programs than in Employment Insurance. Therefore, the percentage of telephone calls answered is considered a key indicator for Income Security, but only a secondary indicator for Employment Insurance.

17.34 The Framework specifies, "Results measurement should strike an appropriate balance between efficiency, effectiveness, cost and quality of service." The Department's key indicators do not

take cost and efficiency into account; only the secondary indicators do so. However, unlike key indicators, secondary indicators are not targeted in all cases and are not subject to reporting to Parliament.

17.35 Costs and results are closely linked. For example, it is important to know how improving service quality impacts on costs. Although the Department has established a number of measures to improve service, it does not always have adequate information to assess the link between the effectiveness and the cost of services. Since its operating costs are expected to be reduced in the coming years (see Exhibit 17.5), the Department will need to consider costs in analyzing the results it achieves.

17.36 The Department has indicated that it intends to review and refine its performance indicators on an ongoing basis. Indeed, as program performance issues evolve, so do the performance indicators. A key indicator may become a secondary indicator and vice versa. The Department is currently revisiting its key indicators for 1998–99. While some adjustments to indicators may be necessary to reflect what has been learned, it is important that they be used for a long

Key indicators, which are subject to reporting to Parliament, do not take cost and efficiency into account.

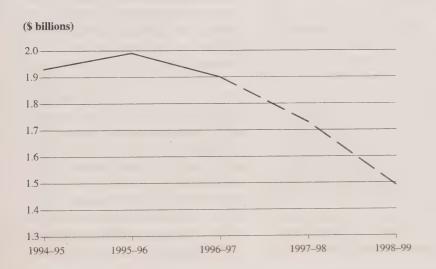


Exhibit 17.5

HRDC Operating Expenditures

Budget — — Actual —

Source: Human Resources Development Canada (HRDC), Part III of the Estimates 1997–98, p. 4–13

enough period to identify trends in order to determine whether performance is improving or deteriorating.

17.37 Furthermore, as the Framework indicates, an essential element of results-based management is the evaluation of overall program effectiveness. Instead, however, the current indicators stress day-to-day management and program outputs. Program results must also deal with outcomes, that is, the effects and impacts of those outputs. This information is generally produced in connection with periodic program evaluations by the Department.

17.38 For example, the Evaluation and Data Development Branch monitors the impacts of the new Employment Insurance legislation. Its activities will include conducting a survey on this program's impact on individuals, performing a qualitative analysis at the community level, and asking specialists to perform impact analyses. This information needs to be examined together with the key indicators in order to report on performance and obtain an overall picture of the results achieved.

Further progress is needed to ensure credibility of data

17.39 A useful system for measuring results is a key factor in successfully implementing an initiative of this kind. The Treasury Board echoed this view in approving the Department's new Planning, Reporting and Accountability Structure on the understanding that it would continue to work "on improving its performance measurement strategies and key results". The data used to measure the achievement of results thus need to be credible. Indeed, both senior management, which uses the data for decision making, and employees, who rely on the data as useful feedback on

their performance, must be able to trust the information or it is likely that the data will not be used, and the entire initiative may be jeopardized.

17.40 Parliament is also a major user of these data. Information on results allows the Minister to answer to Parliament for the effectiveness of HRDC programs. However, as we note in paragraphs 17.47 to 17.66, Parliament currently does not receive all the information it requires. It is important that information provided to Parliament be credible, so that Parliament can use it in its decisions to authorize funding.

An audit by the Department's Internal Audit Bureau revealed certain problems among employees with the credibility of some program data. In the case of the Labour Program, the negative perception could be because the indicators are relatively new. For Income Security Programs, preliminary data are gathered manually, which increases the risk of reduced overall reliability. The Department contends that with the ISP Program Redesign currently under way, its data collection programs will eventually be automated. For the Human Resources Investment Fund, a study by the Evaluation and Data Development Branch is seeking to resolve some of the methodological problems associated with measuring the additional savings generated by the program.

17.42 For a number of years now, the Employment Insurance Program has had a system for the capture, analysis and reporting of performance data. The internal audit report notes that, while improvements are possible, all the features of an effective and useful system are present. Employees are therefore not as concerned about the credibility of data from the Employment Insurance systems.

Employees have expressed skepticism about the credibility of data.

- 17.43 Nonetheless, in various consultations held by the Department, employees have expressed skepticism about the credibility of data. This situation constitutes a major challenge for the Department, since the support of employees, especially in the rank and file and at the local level, is a crucial element that will determine the Framework's success. The internal audit also noted that the monitoring and analysis of performance information has largely been delegated to regional offices and Human Resource Centres of Canada, which may not have the resources and skills needed for the task.
- 17.44 It will be difficult for employees to accept the need for management on the basis of performance targets if they do not feel that the targets are based on reliable data. The internal audit report also notes the need to link performance to the consequences of having met or not met expectations as a step that the Department still has to take. A connection also needs to be made between resource allocation and expected results. It is clear that the Department needs to obtain more solid support from employees if it is to take these steps successfully.
- 17.45 Since acceptance at the local level is vital, the Department needs to resolve, within a reasonable timeframe, the ambiguity surrounding data credibility. Certain quality controls could strengthen confidence in the data and provide a reasonable level of assurance that they are reliable. In its report on this subject, the Internal Audit Bureau stressed the need to test data to ensure that they are relevant and, above all, reliable.
- 17.46 To build on the progress made and to maintain the pace of its implementation of results-based management, the Department should:

- ensure that the choice of key performance indicators takes costs into account;
- ensure the quality of performance data to increase their credibility among employees and managers who use the data; and
- ensure that the selected key indicators remain in place long enough for performance to be assessed over time.

Department's response: The Department takes costs into account when establishing primary indicators and when setting targets for them. Generally, primary indicators are designed to report on results, while costs are tracked through secondary indicators. The Department remains committed to maintain its selected indicators so that performance can be assessed over time.

We are developing a mechanism to maintain data integrity that will allow service delivery partners to transmit data directly to HRDC's systems. Some of the data integrity problems are due to systems problems and data capture methods, which are in the process of being fixed.

Information to Parliament Is Incomplete

- 17.47 The Results-Based Accountability Framework defines the fundamental elements that will allow HRDC to be accountable to employees, partners, clients and parliamentarians for the management of its resources and for the results it achieves.
- 17.48 We examined the information on results communicated to Parliament in HRDC's Estimates Part III, its Business Plan Summary and the Annual Report of the Canada Pension Plan.
- **17.49** The 1997–98 Estimates and the 1996–97 Business Plan Summary do not yet present all the results achieved in

relation to stated objectives for the key performance indicators. It is still too soon to provide this type of information. We encourage the Department to communicate regularly to its employees, partners, clients and Parliament the results achieved as soon as the information is available and credible.

The Annual Report of the Canada Pension Plan is moving in the right direction

17.50 The Annual Report of the Canada Pension Plan (CPP) is an especially important accountability document, since the plan is managed jointly with the provinces and responsibilities are shared among various federal departments. HRDC is responsible for administration of the Canada Pension Plan (Act), except for collecting contributions, which is the responsibility of the Minister of National Revenue. The Minister of Finance and the provincial counterparts are responsible for setting premium rates for the Plan.

17.51 The annual report of the CPP for 1995–96 provides an excellent overview of the responsibilities of the various departments involved. It also presents a good summary of the services offered, the clientele served and the benefits paid. This constitutes a major improvement over previous years.

17.52 In order to make the report complete, we suggest that it include the following elements:

- a discussion of the mandate, objectives and strategies adopted by management, and an explanation of how the activities and services provided support the objectives and the mandate of the CPP;
- a comparison of actual performance with targets or objectives, to complete the

information on achievement of results, when systems allow;

- adequate future-oriented information, for example, the impact of the aging of the population;
- information on the interrelationship between economic and social issues; and
- complete and relevant information on the major activities related to disability benefits.

17.53 The Department should ensure that the Annual Report of the Canada Pension Plan clearly reflects the mandate, objectives and strategies and includes more future-oriented information and, as soon as it becomes available, more complete information on performance in relation to expectations.

Department's response: We agree with the recommendation and will strive to incorporate any relevant strategies, information on future direction of the Canada Pension Plan (CPP), and information on the performance of the CPP against the expected results, as it becomes available. It should also be noted that information on the future direction and projected financial status of the CPP is currently already available in other reporting vehicles, namely Part III of the Estimates and the CPP Actuarial Report.

There is no distinct report on the Employment Insurance Account

17.54 There is no distinct report on the Employment Insurance Account (EIA). Information on the budget and on performance is provided in the Department's Estimates. The audited financial statements are presented in Volume I of the Public Accounts.

17.55 Neither the Department of Human Resources Development Act nor the Employment Insurance Act require that a separate report be prepared and

for 1995–96 constitutes a major improvement over previous years.

The information

presented in the

annual report of the

Canada Pension Plan

submitted to Parliament, apart from a report on the impact of changes brought about by the new legislation, which must be submitted no later than December 31 for the next four years.

17.56 We are concerned that financial information on performance is diffused and that it is difficult to know the results achieved in the operations of the EIA compared with the budget and the Business Plan Summary. Moreover, there is no performance information on the collection of premiums, which is the responsibility of Revenue Canada.

17.57 We believe that the importance and the special nature of the Employment Insurance Account, which is wholly funded by employers and workers, warrants a distinct report that would bring information together in one place, including information on performance, results and the audited financial statements. This report could be linked to the new Performance Report that the Department is to table to Parliament in the fall of each year.

17.58 The Department should produce, on a timely basis, a report providing complete, relevant and timely information on the major activities related to the Employment Insurance Account in order to report on the results achieved and on the management of resources allocated.

Department's response: The requirement to produce an annual report on the Employment Insurance Account (EIA) was eliminated by Parliament through legislation. Information on the major activities related to the EIA reporting on the results achieved and on the management of resources allocated can be found in the Departmental Performance Report and the Report on Plans and Priorities. However, HRDC will explore

the possibility of producing a complete report on the Account.

Actuarial analyses of the Employment Insurance Account are not tabled in Parliament

17.59 Under the Employment Insurance Act, "the Commission shall, with the approval of the Governor in Council on the recommendation of the Minister [of HRD] and the Minister of Finance, set the premium rate for each year at a rate that the Commission considers will, to the extent possible... ensure that there will be enough revenue over a business cycle to pay the amounts authorized to be charged to the [EIA] and ... maintain relatively stable rate levels throughout the business cycle." This is a change from the old Unemployment Insurance Act, and it allows the Account to establish a reserve to finance deficits during a business cycle without having to increase the premium rate.

17.60 In our 1994 Study of Key Federal Social Programs, we noted that a reasonable reserve in the Unemployment Insurance Account would be desirable. It would alleviate the need for borrowing, reduce interest costs thereof, and provide some relative stability in the premium rate as well as protection against unexpected cost increases. At that time, we raised questions we thought deserved consideration, such as what constitutes a reasonable reserve and how much time is required to build it.

17.61 We note that the Commission has not yet come to a decision on what constitutes an adequate reserve and how much time is required to build it to ensure that there will be enough revenue over a business cycle and to maintain relatively stable rate levels throughout the business cycle.

17.62 On the basis of the report of the Chief Actuary of HRDC, the Commission

The Commission has not yet come to a decision on what constitutes an adequate reserve for the Employment Insurance Account and how much time is required to build it.

set the 1997 premium rate for workers at \$2.90 for each \$100 of insurable earnings (the 1996 rate was \$2.95). A reserve of some \$12 billion at the end of 1997 is forecast, representing approximately 1.2 times the forecast average annual amount of regular benefits.

17.63 In this internal report, the Chief Actuary states:

...the amount of reserves needed to ensure 'relative premium rate stability' is not a fixed amount. Reserves will be at a low point towards the end of recessions, and would be rebuilt during an economic recovery. There does not seem to be any need for exceeding an absolute level of about \$15 billion. However, stabilization also involves dealing with the risks of setting up the reserve too quickly or at too high a level — perhaps starting when they would reach or exceed \$10 billion.

The setting of premium rates for the Employment Insurance Account lacks transparency.

17.64 However, the actuarial analyses, so important in setting premium rates for the EIA, are not made public as they are for the Canada Pension Plan. Making the actuarial analyses public would improve the transparency and availability of the data required to know the potential impacts of the options put forward.

Since the actuarial analyses are 17.65 not public information, the setting of premium rates lacks transparency and may be susceptible to influence by factors unrelated to the objectives set out in the Act, namely to ensure that there will be enough revenue and to maintain relatively stable rate levels. Indeed, setting premium rates could be influenced by the fact that any annual surplus or deficit in the Account has an impact on the government's deficit. For example, if the Account had an annual surplus of \$5 billion, the federal deficit for that year would be reduced by the same amount.

17.66 The Department should ensure that the actuarial analyses necessary for setting the premium rate of the Employment Insurance Account, including the level of a reasonable reserve and the time required to build it, are tabled in Parliament to make the setting of premium rates more transparent.

Department's response: All the relevant information with respect to the EI Account is already in the public domain such as in the government's annual economic update, the Budget, Main Estimates and the background material regularly provided with the HRDC press release announcing the annual premium rate decision.

Case 1 — Management of Accounts Receivable

The Department manages one of the largest portfolios of accounts receivable in the government, essentially from the Student Loans, Employment Insurance and Income Security programs. Accounts receivable have grown from \$1.6 billion to \$2.6 billion over the last five years, an increase of \$1 billion or 65 percent (see Exhibit 17.6). Accounts receivable for the Student Loans and **Employment Insurance programs** represent, respectively, 73 percent and 23 percent of the total portfolio. Collection of accounts receivable represents a major source of funding. For example, for the **Employment Insurance Account's** portfolio of accounts receivable, amounts totalling about \$340 million recovered for the 12-month period ended 31 March 1997 represented close to 25 percent of administrative expenditures.

17.68 To better assess the progress made in the transition toward results-based management, we examined the management of accounts receivable, which is shared between program staff and Financial and Administrative Services

staff. Where management of an activity is shared, accountability for results is even more necessary to focus in the same strategic directions the efforts of those involved.

17.69 The active and inactive accounts receivable in the Employment Insurance Program and the Income Security Programs stem essentially from overpayments that have been detected and recorded as amounts to be recovered. Active accounts receivable are collected by program staff from benefit payments to beneficiaries before they are issued. Inactive accounts receivable are those owed by beneficiaries who no longer receive benefit payments; they are recovered by specialized collection agents of the 12 collection centres administered by Financial and Administrative Services. The number of employees working in the collection centres increased from 251 to 310 between 1992-93 and 1996-97.

17.70 The Department also collects from students who have failed to meet their loan repayment obligations.

Responsibility for collecting newly defaulted student loans was transferred to

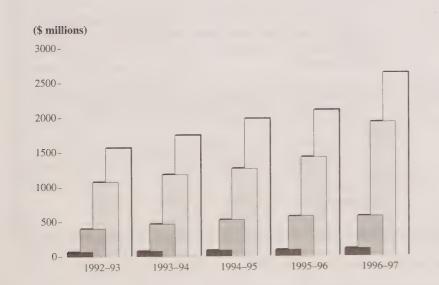
financial institutions in August 1995; hence, the Department's current portfolio of student loans will decrease in the future. At present, the Department sends the defaulted student loans portfolio to collection agencies.

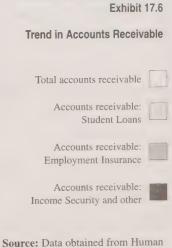
Major efforts are being made to improve performance

17.71 In 1994, senior management decided to integrate and harmonize the management of accounts receivable of all HRDC programs to make collection activities more efficient and effective. In June 1995, HRDC's Priority Steering Committee ratified a strategy and made the following three recommendations:

- develop, communicate and implement a single departmental policy on accounts receivable and collection;
- implement a single Departmental Accounts Receivable System; and
- implement various collection pilot projects to facilitate a decision on the collection strategy and the optimal organizational structure to be adopted.

17.72 The aims of the strategy include reducing overlap in collection activities





Resources Development Canada

between programs and Financial and Administrative Services, improving collection practices and increasing performance results. Exhibit 17.7 shows the major elements of the strategy and the progress made in implementing it.

17.73 Implementing the strategy requires co-ordination and co-operation between program staff and Financial and

Administrative Services staff. Despite progress made for certain elements of the strategy, we noted delays in implementing a number of initiatives, and several pilot projects have not yet been finalized. For example, the Department only very recently began developing a single policy on accounts receivable. Furthermore, not all accounts receivable have been

Exhibit 17.7

Progress Achieved in Implementing the Accounts Receivable Strategy

Major elements of the strategy	Progress achieved
Single policy	 Ongoing consultation between collection unit and programs staff for raising and resolving policy issues of mutual interest.
	• Review of the relevance of hardship in the collection process under way.
	Review of policies on write-off of debts and internal set-off under way.
Departmental Accounts Receivable System (DARS)	Development of the DARS and transfer of accounts from the Canada Pension Plan (CPP). A transition plan was developed to include all the Department's other accounts receivable.
	Pilot project for a corporate letter system.
	Development of an interest calculation function.
Use of private collection agencies	Regional working group set up in October 1996.
Osc of private conceilon agencies	 Initial identification and analysis of issues completed for accounts receivable of the Employment Insurance Program only. Evaluation of selection criteria has not been finalized.
Responsibilities for collection	 Management of collection activities for inactive accounts transferred from the CPP to Financial and Administrative Services (FAS).
	 Monitoring of the activities of private collection agencies partially transferred to FAS.
Sharing of information between programs	Examination of policy and legislative barriers between programs by an interdepartmental committee. An action plan is being prepared.
Collection tools	 Implementation of a monthly account statement system in two regions. Pilot project on the organizational and technological shift, particularly benefits arrangements.
Interprogram set-off	Establishment of a working group to identify application criteria.

Source: Information obtained from Human Resources Development Canada, March 1997

transferred yet to the new departmental system.

We believe an action plan setting 17.74 out roles and responsibilities, priorities, resource requirements and timetables for bringing the strategy to completion would be beneficial.

17.75 The Department should complete the implementation of the strategy to integrate and harmonize the management of accounts receivable in order to improve performance results.

Department's response: We concur with this recommendation and will continue to work toward full implementation of the strategy as quickly as possible so that performance results for all HRDC receivables will be optimized and reflect

the benefits of an integrated and harmonized approach to debt management and recovery.

Performance could be better measured and targeted

17.76 Choosing key performance indicators allows management and employees to concentrate on the strategic results promoted by the Department. Although the Results-Based Accountability Framework does not specify key or secondary performance indicators for management of accounts receivable, we noted that managers are using some in the majority of accounts receivable (see Exhibit 17.8). The Department recently formed a committee An action plan for bringing the accounts receivable strategy to completion would be beneficial.

	· ·		Perfor	
Performance Indicators				
Active accounts: - amounts recovered	Active accounts: • none	Loans collected by private collection agencies:	Receivable	
Inactive accounts:	Inactive accounts:	net recovery ratenumber of accounts over six		

Income Security

- · amounts recovered

Employment Insurance

- · unit cost per dollar recovered
- · recovery rate
- · write-off amount rate
- · average payment
- · recovery by full-time equivalent
- penetration effectiveness¹

· compliance with directives Loans collected by the

· amounts recovered

Department:

· complaints received

· accuracy of accounts

Student Loans

months with a repayment

Performance expectations

Active accounts:

• none

Inactive accounts:

· amounts to be recovered

average number of inactive accounts.

Active accounts:

none

none

Inactive accounts:

none

Loans collected by private collection agencies:

none

Loans collected by the Department:

none

Source: Information obtained from Human Resources Development Canada

Exhibit 17.8

rmance Indicators and ectations for Accounts le, by Program - 1997

¹ Penetration effectiveness is calculated by dividing the average number of cash payments by the

Performance targets have not been set for a significant portion of the portfolio of accounts receivable.

to select appropriate performance indicators for all accounts receivable.

It is important that performance 17.77 information cover key elements so that managers can make the most appropriate decisions, particularly in selecting collection methods. The Department uses various collection methods to recover amounts owing as quickly as possible. A comparison by collection method of the amounts recovered with the collection costs would enable the Department to select the most cost-effective method. However, management systems currently cannot provide information about the cost of each collection method. It is therefore difficult for managers to determine the appropriate mix of collection methods to improve performance.

Exhibit 17.8 shows that performance targets have not been set for a significant portion of the portfolio of accounts receivable. For example, active accounts receivable in the Employment Insurance Program, which represent a substantial portion of that program's total as of 31 March 1997, have no performance targets. With respect to the portion of the student loans portfolio collected by private collection agencies, the Department's view is that performance is a product of sound competition among the agencies, given that new defaulted student loans are allocated to them based on performance achieved according to a set of criteria.

17.79 We believe that setting performance targets for the overall portfolio of accounts receivable would enable the Department to better focus on results and to assess performance. Without performance targets, it is difficult for senior management to determine whether or not strategic directions have been achieved.

17.80 The Department should ensure that performance indicators and targets cover all key aspects of the management of the portfolio of accounts receivable. It should also evaluate the cost effectiveness of various collection methods.

Department's response: We agree with the recommendation that performance indicators for all of the portfolio of accounts receivable be utilized and that collection methods be evaluated for cost effectiveness.

As the Department's Accounts Receivable Strategy evolves and the initiative to harmonize various HRDC program recovery policies is realized, it will enhance our ability to set realistic target levels for all aspects of the management of the portfolio.

A more thorough analysis of performance is needed

17.81 It is essential to know the causes of changes in performance achieved and in collection costs to identify and implement any needed corrective measures in a timely manner. The Department could perform a more thorough analysis of the reasons for such changes in the performance of its collection activities and in the quality of the portfolio of accounts receivable. We present in the following paragraphs examples of analyses that the Department could undertake.

17.82 The analysis in Exhibit 17.9 shows that the annual combined rate of recovery of accounts receivable for the Student Loans and Employment Insurance programs has consistently declined over the last five years, from 24 to 17 cents per dollar available for collection, a decrease of close to 30 percent. This decrease is due, in part, to the decline over the same period in the rate of recovery of accounts receivable for the Employment Insurance

Program, from 46 to 37 cents per dollar available for collection.

quality of the portfolio of accounts receivable has deteriorated over the last five years, in part because of the increase in the age of accounts receivable. In other words, the older the accounts, the more difficult it is to recover the amounts due. As Exhibit 17.10 shows, accounts receivable in the Employment Insurance Program are becoming older; and the amounts in student loans older than four years expressed as a percentage of the outstanding total increased from 39 percent to 50 percent during the last five years (see Exhibit 17.11).

17.84 With respect to the Employment Insurance Program, the lower rate of recovery and older age of the accounts receivable are due to a decrease over the last five years in amounts recovered before benefit payments are issued to beneficiaries who owe outstanding amounts. Active accounts receivable are managed by program staff who are not specialized collection agents. Since this program has only one performance

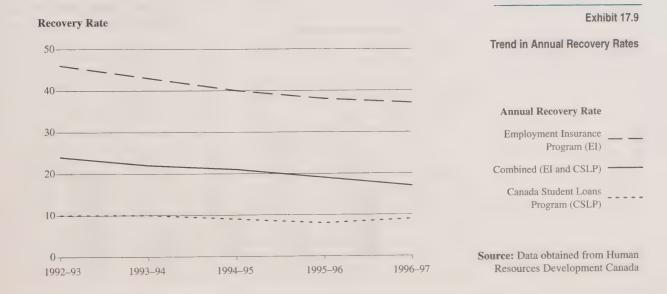
indicator and no performance target for managing active accounts receivable (see Exhibit 17.8), it is difficult to determine whether they are managed properly and whether performance results are appropriate.

17.85 We believe that the use of performance indicators and targets for the overall portfolio of accounts receivable would enable the Department to better assess whether the overall performance of the portfolio has improved or deteriorated. The Department has informed us that the Accounts Receivable System now being developed will allow it to compile more performance information and will therefore facilitate analysis of changes in the cost effectiveness of collection activities.

17.86 The Department should analyze thoroughly the causes of changes in the cost effectiveness of collection activities and in the quality of the portfolio of accounts receivable, in order to identify and implement in a timely manner any needed corrective action.

Department's response: We concur with this recommendation, and the Accounts Receivable Strategy initiatives, once fully

The quality of the portfolio of accounts receivable has deteriorated over the last five years.



> implemented, will provide a means by which the effectiveness of recovery operations generally, and recovery tools and techniques specifically, may be more accurately measured and evaluated, both in terms of efficiency and cost effectiveness.

Certain collection practices can be improved

This section deals exclusively 17.87 with accounts receivable collection

practices in the Employment Insurance Program and the Income Security Programs. We did not examine the collection practices used by private collection agencies. The Department's collection policies state that an attempt should first be made to obtain the full amount of the debt and that the debtor should expect to have to liquidate certain assets in order to repay the government.

Exhibit 17.10

Aging of Accounts Receivable in the **Employment Insurance Program**

Less than 1 year

1 to 4 years

More than 4 years

Source: Data obtained from Human Resources Development Canada

Percentage of Accounts

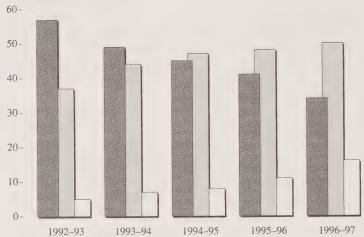


Exhibit 17.11

Aging of Accounts Receivable in the Student Loans Program

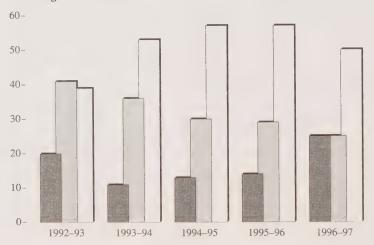
Less than 1 year

1 to 4 years

More than 4 years

Source: Data obtained from Human Resources Development Canada

Percentage of Accounts



17.88 We noted some areas where collection practices need to be strengthened to improve performance and make management more results-based:

- Collection priorities are not based on debtor risks and profiles. It is essential that collection efforts be properly prioritized in order to recover the amounts owing as quickly as possible.
- Amounts to be recovered from benefit payments destined to debtors are predetermined by the Department. It does not seek to immediately recover the full amount or a large portion of the debt, even if the financial situation of the debtor so permits.
- The debtor's assets are not considered in assessing the capacity to pay as required. The Department's system is not designed to record information on assets.
- Errors and major delays were observed in the recording and recovery of overpayments, as well as errors in accounts receivable balances recorded in the Departmental Accounts Receivable System for the Income Security Programs.

17.89 The Department should strengthen its collection practices to improve performance and make management more results-based.

Department's response: We concur with this recommendation. The HRDC Accounts Receivable Strategy was developed with a view to ensuring that all HRDC debtors are treated in a fair, consistent and equitable manner, while at the same time maximizing recoveries through utilization of the most cost-efficient recovery tools and techniques, targeted to specific categories of accounts. With the full implementation, over the next three years, of all elements of the Accounts Receivable Strategy, the Department will have much improved collection tools and an enhanced capacity

to measure the effectiveness of specific recovery methods and practices.

Case 2 — Protection of Program Integrity

17.90 One of the Department's main objectives is to protect public funds against fraud and abuse in order to ensure that payments are made to all those and only those who are entitled to them. The Department has activities to prevent, detect and deter fraud and abuse in the Employment Insurance Program, the Income Security Programs and The Atlantic Groundfish Strategy. We examined whether the management of those activities is results-based. The provinces are responsible for protecting public funds against fraud and abuse in the Canada Student Loans Program.

Management of the integrity of the Employment Insurance Program is results-based

17.91 The Results-Based Accountability Framework sets out both the key and secondary indicators of performance for the protection of public funds in the Employment Insurance Program only. Exhibit 17.12 presents a summary of the performance indicators and expectations for the three programs. Since resource levels have been based on expected results, the Program Integrity Directorate in Income Security Programs has measured the results of certain activities for the protection of public funds in terms of total savings. However, the results of other activities are not measured.

17.92 The Investigation and Control Directorate of the Employment Insurance Program has, since 1992, managed activities for the protection of public funds in accordance with expected results. It operates at the national, regional and local levels. The differentiation of roles and responsibilities among these three levels is

Key and secondary performance indicators and expectations for the protection of public funds have been set for the Employment Insurance Program only.

well defined. For example, directors of Human Resource Centres of Canada (HRCCs) are responsible for results; that is, they must make every effort to ensure that the savings expectation expressed in terms of total savings is met.

17.93 Information on results, measured in terms of total savings, is used to negotiate the level of resources required and to set the national savings expectation. Total savings comprise direct and indirect savings. Direct savings measure the value of overpayments detected and penalties imposed. Indirect savings represent the estimated value of improper payments not made as a result of investigations.

17.94 Exhibit 17.13 shows that total savings have grown since 1992, reaching a peak in 1995–96 and then declining in 1996–97. Although the Directorate failed

to reach its savings expectation in the last two years, performance measured in terms of total savings is up over the last five years. The increase in total savings is due mainly to indirect savings, which nearly quadrupled from \$68 million to \$249 million during that period.

17.95 The adoption of total savings as a key indicator of performance has had a marked impact on the nature and scope of investigation and control activities, by encouraging managers to emphasize not only detection (measured by direct savings) but also prevention and deterrence (measured by indirect savings). Indirect savings as a proportion of total savings more than doubled over the last five years, climbing from 17 percent to 44 percent.

17.96 Efforts in prevention and deterrence have helped to improve the

Exhibit 17.12

Performance Indicators and Expectations for Protection of the Integrity of Public Funds – 1997

Employment Insurance		Atlantic Groundfish Strategy
Perfor	nance Indicators	
Primary indicator:	Primary indicator:	Primary indicator:
• total savings	• none	Although no performance indicators are set out in the
Secondary indicators:	Secondary indicators:	Results-Based Accountability Framework, the Department uses total savings as the performance
• return in dollars and on investment	• none	
• intervention rate		
 percentage of disqualifications and disentitlements out of the number of claimant investigations 		measure
• percentage of penalties imposed out of the number of investigations completed		Secondary indicators: • none
 investigations by full-time equivalent (productive time) 		· Hone
Perform	nance Expectations	
• total savings	• none	• none

Source: Information obtained from Human Resources Development Canada, 1997

return on investment over the last five years (see Exhibit 17.14). The Directorate told us that a recent decrease in total savings and return on investment was due in part to the introduction of the new *Employment Insurance Act* in June 1996 and to the overall reduction in the size of the program in terms of benefits paid. The new *Employment Insurance Act* has required a major effort to train investigators, which has contributed to reducing the number of investigations each one conducts.

17.97 The use of performance indicators and expectations enables results-based management of the protection of the integrity of the Employment Insurance Program.

However, this is not the case for Income Security Programs and The Atlantic Groundfish Strategy, which lack performance indicators and expectations.

17.98 The Department should ensure that the results of all activities for the protection of public funds against fraud and abuse in Income Security Programs and The Atlantic Groundfish Strategy are properly measured and that

expectations are set in order to manage for results.

Department's response: We concur with this recommendation.

Performance could be analyzed more thoroughly

17.99 The Investigation and Control Directorate of the Employment Insurance Program has made major progress toward results-based management in the last five years. It has refined its methods of measuring and communicating results and has broadened its investigative methods to improve performance. However, we did note room for some improvements that would make management more results-based.

17.100 The national savings expectation is distributed among the regions. However, some regions do not allocate savings expectations among Human Resource Centres of Canada (HRCCs), or do so informally. Uniform methods of allocating savings expectations would make it easier for Centre directors to accept the expectation and would facilitate comparison of performance among Centres in the various regions.

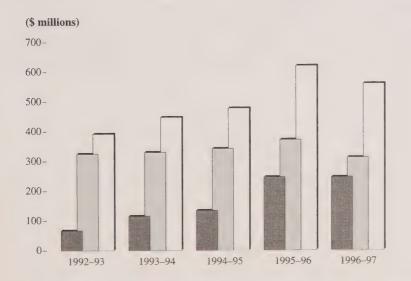


Exhibit 17.13

Trend in Total Savings Investigation and Control Directorate, Employment Insurance Program

Indirect savings Direct savings

Total savings

Source: Data obtained from Human Resources Development Canada

A more thorough analysis of the causes of performance differences between Human Resource Centres would be beneficial.

17.101 Comparing results obtained with costs incurred makes it possible to assess the cost effectiveness of activities to protect public funds. The Department calculates return on investment at the national level and for each region and HRCC, in order to compare results with costs. Since no expectation is set for this performance indicator, however, it is difficult to determine whether or not the activities for protecting public funds are cost-effective.

17.102 The Investigation and Control Directorate uses a variety of investigative methods to reach the national savings expectation. Although it measures the total savings generated by each investigative method, it does not assess the cost effectiveness of each method because its information on costs is not detailed enough. It is hence difficult for managers to determine an appropriate mix of investigative methods to improve the cost effectiveness of activities.

17.103 The Directorate regularly prepares and communicates information on performance indicators. Performance varies significantly among regions and

among HRCCs. A more thorough analysis of the causes of performance differences would be beneficial; by examining actual performance compared with expected results, the Directorate could identify any needed corrective actions. For example, the Business Plans of the Centres could clearly indicate the causes of discrepancies between actual and expected results and the appropriate corrective actions to be taken. We note that the Directorate recently set up, at the national level, a special unit whose mandate includes analyzing more thoroughly the causes of performance variances among regions.

17.104 The Investigation and Control Directorate of the Employment Insurance Program should conduct a thorough analysis of the causes of discrepancies between actual and expected results and of changes in cost effectiveness in order to report properly on results achieved and to identify the need for corrective action.

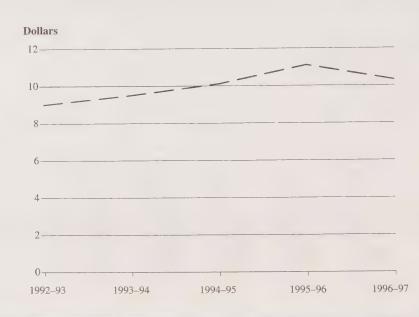
Department's response: We agree with this recommendation, and this process is already under way. We have a three-pronged approach: 1) an evaluation

Exhibit 17.14

Trend in Return on Investment of \$1 Investigation and Control Directorate, Employment Insurance Program

— Return on investment

Source: Data obtained from Human Resources Development Canada



study by HRDC's Strategic Policy Branch;
2) a survey of front-line staff; 3) more
in-depth analysis of administrative and
performance data. All of this will be
discussed by senior managers, at the
director-general level, at Management
Board and with the Commissioners.

Conclusion

17.105 The Department has recently undertaken a transition toward results-based management. It has launched a number of initiatives such as the selection of performance indicators, the setting of expectations, and consultations with employees. In addition, the roles and responsibilities of the various federal partners in the administration of two of the largest programs (the Canada Pension Plan and the Employment Insurance Account) are, overall, well defined. We concluded that the Department has made progress toward the completion of the transition.

17.106 Nevertheless, the Department still needs to take certain key steps that are critical to the success of an initiative of this magnitude. It needs to ensure that it has chosen its key performance indicators carefully and that they are relevant over time. It also needs to set expectations for all its programs and to ensure the credibility of the data that employees consider most important.

17.107 Our examination of the management of accounts receivable and the protection of program integrity confirms our conclusion that major progress has been made in results-based management but that certain steps are still needed in the area of performance measurement and analysis.

17.108 In addition, at the present time, very little information on results is communicated to Parliament. The information that is provided on the Employment Insurance Account can be greatly improved. With the implementation of the *Results-Based Accountability Framework*, the Department has positioned itself to start providing Parliament with better information on results.

17.109 Measurement of performance results, and follow-up, will require a firm commitment by senior management and the co-operation of all members of the organization, at the local, regional and national levels. The recent experience acquired by the Investigation and Control Directorate in the Employment Insurance Program could provide senior management with guidance and encouragement. Decisions and adjustments will be necessary if results measurement is to strike an appropriate balance among the effectiveness, cost and quality of services.



About the Audit

Objectives

The objective of our audit was to examine one of the major elements of the *Results-Based Accountability Framework* — results-based management. More specifically, we sought to:

- examine progress achieved toward results-based management;
- determine whether the Department is appropriately fulfilling its responsibilities and reporting on
 performance achieved on the basis of performance expectations for two selected activities —
 management of accounts receivable and protection of program integrity; and
- examine information to Parliament on the Department's two largest programs (the Canada Pension Plan and the Employment Insurance Account), including information on results.

Scope

Our audit covered the implementation of results-based management for the entire Department. In order to better assess progress in the transition toward results-based management, we examined management of accounts receivable and protection of program integrity. Chapter 11 on a government-wide study entitled Moving toward Managing for Results identified some lessons learned and best practices in results-based management by the Investigation and Control Directorate of the Employment Insurance program.

We examined the information on results communicated to Parliament. Our audit efforts here were focussed on the Department's two largest programs, the Canada Pension Plan and the Employment Insurance Account.

We interviewed officials at headquarters and some partners of the Department such as the Chief Actuary of the Office of the Superintendent of Financial Institutions. We visited three collection centres, two Human Resource Centres of Canada and two regional offices, located in Ontario and Quebec. We analyzed planning documents, minutes, performance reports and other related documents. As appropriate, we used the work and the related reports of the Internal Audit Bureau.

Criteria

- A management framework for implementing results-based management should be established to ensure, among other things, that initiatives and related activities are closely linked to the Department's mission and operating principles.
- Roles and responsibilities should be clearly defined and accepted in order to promote accountability and achievement of performance and results.
- Reasonable expectations of performance and results should be clearly set out and accepted in order to fulfil responsibilities and achieve objectives.
- Sound management practices and appropriate management systems should be used in order to suitably fulfil responsibilities.
- Information on performance and results should be credible, analyzed and communicated in a timely manner to senior management and Parliament for decision making and accountability.

Quantitative information

The quantitative information in this report has been drawn from various sources indicated in the text. Unless otherwise indicated, reasonableness of this information has been examined but not audited.

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Report of the Auditor General of Canada to the House of Commons

Chapter 18

Revenue Canada and Department of Finance – Fostering Improvement in Tax and Trade Administration: Follow–up of Previous Audits



Report of the Auditor General of Canada to the House of Commons

Chapter 18

Revenue Canada and Department of Finance – Fostering Improvement in Tax and Trade Administration: Follow–up of Previous Audits

This October 1997 Report comprises 11 chapters and a Foreword and Main Points. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

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Chapter 18

Revenue Canada and Department of Finance

Fostering Improvement in Tax and Trade Administration: Follow-up of Previous Audits

The follow—up work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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Assistant Auditor General: Shahid Minto Responsible Auditor: Jim Ralston

Revenue Canada and Department of Finance

Fostering Improvement in Tax and Trade Administration: Follow-up of Previous Audits

Main Points

- 18.1 Over the last few years, Revenue Canada and the Department of Finance have made many changes to systems, procedures and practices that have strengthened tax and trade administration. Some of these changes are a result of the departments' own commitments to improving their operations; some changes were in response to reports of parliamentary committees; and other changes were made to respond to our observations and recommendations in reports on our value-for-money audits.
- 18.2 Our follow-up on previous recommendations found that progress is being made on a number of fronts. We encourage the two departments to continue their efforts to address the areas where concerns remain.
- 18.3 Revenue Canada is now making available more income tax advance rulings and GST rulings and interpretations and has taken steps to improve its documentation of key decisions leading to advance rulings.
- 18.4 The Department continues to have difficulty completing reviews of income tax returns selected for scrutiny during the annual processing program. It has expanded the number of processing review fields it is tracking, and it is maintaining year-to-year consistency in the fields chosen. Data quality improvements are expected to improve Revenue Canada's ability to analyze and evaluate the performance of the processing program.
- 18.5 The integration of collections for income tax, GST and customs and excise, the establishment of a risk analysis system, and changes in collection procedures are expected to enhance the collections function. A new procedure for early contact on large delinquent accounts is proving to be very productive, bringing in \$181 million in 1996–97. Revenue Canada has published guidance on applying the Fairness Package and has established a system to track its use.
- 18.6 The Department is shifting from an audit selection strategy focussed on identifying individual taxpayers to one focussed on industry sectors. It is also trying to take advantage of administrative consolidation to increase audit visibility and coverage. However, the Department still does not have a verification program aimed at RRSP contributions. Through improved reporting of social insurance numbers and sharing of data with other federal departments and provincial governments, Revenue Canada is improving its ability to pursue income tax non-filers and GST non-registrants.
- 18.7 It has developed a process to manage the risk associated with complex tax legislation, which can be a source of revenue leakage if provisions can be used for tax avoidance. It has also improved the collection and reporting of performance data across a number of its programs.
- **18.8** In trade administration, Revenue Canada's periodic verification initiative and country-of-origin audit program are expanding. The Department's small importer strategy has been formulated and implementation started.
- 18.9 With respect to tax assistance for retirement savings and income tax incentives for research and development, the Department of Finance has taken steps to provide improved estimates of program costs and to provide evaluations of program effectiveness. It has also taken steps to correct technical deficiencies in the law related to foreign affiliates and taxpayer migration.



Introduction

18.10 Revenue Canada and the Department of Finance have made many changes to their systems, procedures and practices that have strengthened tax and trade administration. This is evident in the

Government of Canada Budget Plan – 27 February 1995, as illustrated in Exhibit 18.1. Some of these changes are a result of the departments' own commitments to improving their operations; some were made in response

Strengthening the Performance of the Tax System

The Auditor General has chosen this area for special attention in his report. He states that action is required to safeguard the tax base and to prevent the erosion of federal revenues. The vast majority of taxpayers comply with the tax laws; however, some do not. Non-compliance with tax law results in lower tax revenues and undermines the government's ability to fund programs and service the debt. The integrity and fairness of the tax system depends on all Canadians paying the tax they owe.

Specifically, the Auditor General refers to the need for effective tax collection practices and for appropriate enforcement strategies that will improve detection and action against those not complying with the tax laws. This budget proposes the following actions aimed at ensuring that taxes are paid on time and that Revenue Canada's ability to enforce compliance is improved:

- increasing the interest rate on unpaid income taxes;
- enhanced reporting requirements in respect of payments made within the construction industry;
- new reporting requirements for foreign investments including foreign trusts;
- improving Revenue Canada's ability to require production of information on third parties in order to verify compliance;
- improving Revenue Canada's approach to the audit of large business; and
- tightening the rules with respect to the remittance of source deductions and GST.

In addition, Revenue Canada has taken a number of steps to address the concerns expressed by the Auditor General:

- consolidating taxation and excise/GST collections programs and implementing joint income tax/GST audits;
- achieving efficiencies through exchanges and sharing of client information, integrated collections actions and computer cross-references and links;
- establishing a Compliance Research Division in Revenue Canada to better identify non-compliance and ways to improve compliance; and
- implementing a communications strategy under which prosecutions and convictions are publicized in order to deter non-compliance.

The Auditor General also noted that customs officers were overburdened and that there was a consequent loss of customs revenue. In response, Revenue Canada is undertaking a fundamental re-engineering of Customs' commercial operations to redesign the relationship with clients. Further, it is moving to more self-assessment which puts greater responsibility on the importer.

Finally, the Auditor General commented on the need for better monitoring and reporting on the performance and results of the tax expenditures on research and development and on retirement savings. With regard to research and development, a Revenue Canada-Department of Finance working group has been established to improve the information flow between the departments. In addition, as noted above, a joint Finance-Revenue Canada evaluation of the scientific research and experimental development tax incentives is underway and the results will be published once this work is complete. Similarly, an evaluation of the 1991 reforms to the tax assistance for retirement savings is also being undertaken and the results of this study will also be published.

Exhibit 18.1

Government of Canada Budget Plan – 27 February 1995

to reports of the Public Accounts Committee; and others were made to respond to our observations and recommendations in reports on our value-for-money audits.

18.11 A strong tax administration is needed to provide government with a reliable stream of revenue to fund its programs. A strong tax administration protects the integrity of the tax base. For an income tax, the tax base comprises the total taxable income of taxpayers; for a consumption tax like the Goods and Services Tax, it is the total value of taxable transactions that occur in the economy. The tax base is one of the most valuable assets of a civilized society, and parliamentarians, government and the public have a vested interested in preserving it.

18.12 Protecting the integrity of the tax base means ensuring to the greatest possible extent that people report their income and transactions truthfully and pay the taxes that they owe. Canada has chosen a self-assessment system for collecting taxes, which puts the onus on each person or business to calculate the amount of tax due. People are most likely to comply with these obligations if they are satisfied that the tax system is fair. They have a right to expect that those who do not pay their fair share will be detected and dealt with accordingly.

18.13 To the extent that trade administration results in the generation of revenue from customs duties, the preceding remarks apply equally. However, in addition, trade administration is increasingly aimed at enabling Canadians to participate more effectively in the international marketplace and to reap gains from trade.

18.14 This chapter follows up on 15 value-for-money audits conducted

between 1992 and 1996, and discusses the extent to which Revenue Canada's and the Department of Finance's actions on our recommendations and on those of the Public Accounts Committee (PAC) have improved tax and trade administration. We followed up on all of the PAC's and our recommendations from those audits and are reporting on the more significant ones and on those where we feel progress has been unsatisfactory. Further details on the follow-up scope and objective are found at the end of the chapter in the section About the Follow-Up.

Conclusions

18.15 It is our practice to select audit topics to cover as much of the "audit universe" as practical in a cycle that extends over eight to ten years. The five years of audits covered here represent only a slice of the audit universe. Some key departmental activities were not touched upon in this set of audits. We have not exhausted the analysis of any one activity and we have not covered each activity to the same extent.

18.16 However, we do believe that Revenue Canada has made satisfactory progress in addressing most of the recommendations contained in the audits followed up in this chapter and the related recommendations of the Public Accounts Committee, and in advancing certain of its initiatives that were identified in the original audit reports.

18.17 We continue to have concerns about some matters previously reported, and we again urge Revenue Canada to take appropriate remedial action.

18.18 We are generally satisfied with the Department of Finance's response to our recommendations and to those of the House of Commons committees that considered our reports dealing with

Revenue Canada and the Department of Finance have made many changes to their systems, procedures and practices that have strengthened tax and trade administration.

taxation. While they are not yet available, we anticipate better estimates of tax expenditures and better evaluations of the extent to which the programs of tax assistance for retirement savings and incentives for research and development are achieving their objectives. In addition, the government has taken action to deal with technical deficiencies in law related to foreign affiliates and taxpayer migration.

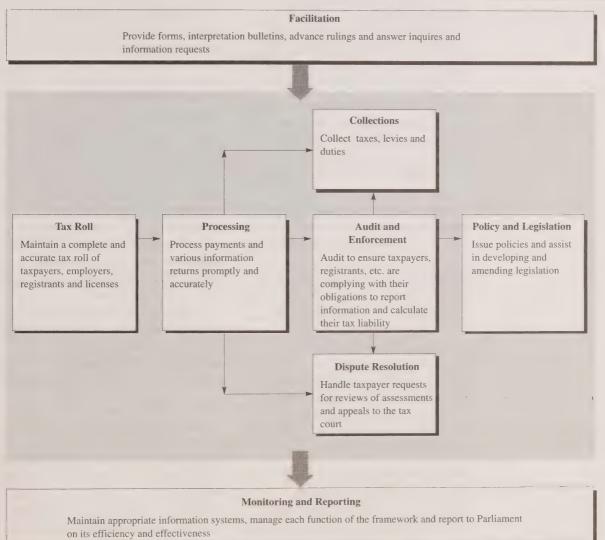
REVENUE CANADA

Tax Administration Framework

18.19 The findings of our follow-up are organized in this chapter using a simplified tax administration framework (see Exhibit 18.2) patterned on Revenue Canada's official activity structure. This

Exhibit 18.2

Tax Administration Framework



section explains the elements of our simplified tax administration framework.

Facilitation. Overlaying all other tax administration functions are Revenue Canada's efforts to help taxpayers, registrants, etc. comply with their obligations under the tax system. Facilitation takes many forms, such as communicating to clients their rights and obligations, providing the necessary forms and information for filing returns, and responding to client enquiries. The Department also issues various kinds of rulings that explain how certain transactions ought to be treated for tax purposes or that confirm or deny a taxpayer's interpretation of the way a proposed transaction ought to be treated. The goal is to create a better-informed body of taxpayers, registrants and others.

Tax Roll or Registry. Revenue Canada needs to maintain a complete and accurate "tax roll" of taxpayers and employers (income tax), registrants (Goods and Services Tax), and licensees (excise tax and customs duty), by or through whom taxes are paid. In addition, it keeps certain special purpose registries, such as a registry of pension plans in respect of which taxpayers may claim deductions for their contributions. A tax roll or registry is simply a record of pertinent information that enables the Department to communicate with taxpayers, employers, registrants, licensees and plan administrators to facilitate or enforce compliance with the tax system. Identifying persons who should be added to or deleted from a particular tax roll or registry is a basic and vital function of tax administration.

18.22 Processing. For taxpayers, employers, registrants and licensees, compliance with the tax system means making payments and sending in various information returns to Revenue Canada.

traditionally on paper, but increasingly in electronic format. This amounts to millions of transactions each year, which the Department has to process promptly and accurately. A very important aspect of processing transactions is applying automated and manual controls and procedures that identify and respond to indicators of actual or potential non-compliance.

18.23 Collections. Taxpayers, employers, registrants and licensees are supposed to remit their taxes to Revenue Canada voluntarily. The amount of the tax liability may have been determined by self-assessment or an assessment by Revenue Canada. When debtors fail to or are unable to pay their tax liabilities, for any reasons, Revenue Canada has to take action to collect the amounts due. The action it takes depends on the circumstances.

18.24 Audit and Enforcement.

Because Canada uses a self-assessment system of taxation, Revenue Canada needs to carry out a limited program of checking (auditing) to ensure that taxpayers, registrants, etc. are complying properly with their obligations to report information and calculate their tax liability. When the Department finds errors or non-compliance, it issues new assessments or takes other corrective action. In cases where Revenue Canada suspects fraudulent activity, it may seek criminal prosecution through its enforcement arm, Special Investigations.

Canada maintains a separate organizational unit that reviews assessments raised by the Department that taxpayers believe are incorrect. If a matter referred to this unit is not resolved to the satisfaction of the person who raised the objection, it may be appealed to the tax court, which is fully independent of

Revenue Canada. (Although it is a vital element of tax administration, none of the tax-related audits followed up in this chapter dealt with dispute resolution. In 1995 we followed up our previous work in this area, originally reported in a 1992 chapter on resolving disputes on income tax assessments).

18.26 Policy and Legislation. In the course of administering the tax system, Revenue Canada becomes aware of anomalies or ambiguities in legislation. Audit and appeals activity are important sources of this kind of information. The Department may clarify or correct such problems by issuing its own policy statements or may ask the Department of Finance to amend the legislation, depending on the circumstances.

18.27 Monitoring and Reporting.

Each of the functions we have discussed has to be managed appropriately and information on its efficiency and effectiveness reported to Parliament. Both of these tasks depend on having and using suitable information systems.

Observations

Compliance Strategy

Risk assessment guides compliance strategy

18.28 How Revenue Canada uses the elements of the tax administration framework is determined by its compliance strategy. Revenue Canada has always used all of the elements but increasingly has asked itself whether it is using them in proper proportion and in the most effective way. We have seen a change in Revenue Canada's strategy in recent years. As the Department describes it, "Today's approach relies on sophisticated risk assessment and risk

management techniques made possible through advanced computer technologies." Underlying this approach is a much greater focus on using more and better information to guide the Department's actions.

Facilitation

Publishing more rulings enhances facilitation

18.29 Our 1993 Report (Chapter 20) dealt in part with advance income tax rulings. These are written statements given to a taxpayer by Revenue Canada specifying how the Department will interpret and apply particular legislative provisions to a specific transaction or transactions that the taxpayer proposes to carry out. We observed in 1993 that few of the departmental positions responding to requests for advance income tax rulings were made public, even though many would be of interest to other taxpayers. Accordingly, we recommended that Revenue Canada release to the public, in severed form, all advance rulings issued. By "severed form" we mean in a manner that keeps confidential the identity of the taxpayer who sought the ruling.

18.30 Our follow-up noted that since 1 January 1996 the majority of income tax rulings have been severed and are available to the public electronically in Revenue Canada's offices across the country. To protect confidentiality, the taxpayer requesting a ruling is asked to approve the severed version before it is published. The Information Circular explaining the rulings process has been updated and the revised circular states that agreement to the publication of a severed ruling is a condition for obtaining a ruling.

18.31 In the interim, the Department has realized that when there are more than two parties to a ruling it is difficult, if not impossible, to follow the facts and

The Minister of
National Revenue
announced
improvements to the
Department's
documentation
practices in respect of
advance rulings.

proposed transactions after the taxpayers' names have been severed. It is currently considering a number of enhancements to make the severed rulings as useful as possible to taxpayers.

observations on three classes of GST rulings: advance rulings, application rulings and interpretations. It noted that communicating more information to the public on rulings and interpretations would increase equity among GST registrants. Revenue Canada is now providing subscribers (mainly tax publishing houses) with an electronic version of all GST rulings and interpretations, in severed form, prepared in departmental headquarters. However, GST rulings and interpretations prepared in Tax Service Offices are not distributed.

Department to improve documentation of key decisions leading to advance rulings

18.33 In response to our May 1996 audit observation concerning the movement out of Canada of at least \$2 billion of assets held in family trusts, the Minister of National Revenue announced improvements to the Department's documentation practices in respect of advance rulings. Our report had noted a lack of documentation and analysis of key decisions leading to the issuance of certain advance rulings.

Community visits combine facilitation and enforcement

18.34 One of the Department's action plans lists an example of a new approach that combines facilitation and enforcement: visiting local businesses to obtain information and provide advice to ensure proper filing and registration.

Revenue Canada reports that it has visited over 21,000 businesses in 126

communities. One third of the businesses visited required further action to improve their compliance.

Tax Roll

Reporting of social insurance numbers has increased

18.35 When people file income tax returns for the first time, their names are inscribed on the tax roll. In the case of the GST, businesses identify themselves to Revenue Canada by applying for a registration number (the Business Number). Similarly, for an excise tax like the air transportation tax, companies apply to be licensed. In each case, once Revenue Canada is aware of a person's or a business's existence, it can monitor compliance with the tax laws.

18.36 Because identification is so important, the Department has programs aimed at identifying non-filers and non-registrants. Our 1994 chapter on detection of non-filers looked at this problem with respect to income tax.

The key to finding those whose names should be on the tax roll but are not is to obtain from an independent source of information a clue to their existence and an indication that they ought to be paying tax. One such source is the record of investment earnings ("T5 slips") that financial institutions have to prepare. To be most useful to Revenue Canada, T5 slips have to contain the social insurance number (SIN) of the person who received the investment earnings. This makes possible computerized matching of the T5 slips to income tax returns, on which the SIN appears. Although people are required by law to give their SIN to financial institutions, many do not, despite reasonable efforts by financial institutions to obtain the numbers.

18.38 Our chapter noted that, for the 1992 taxation year, only 73 percent of T5s

contained SINs. For the 1995 taxation year, Revenue Canada reports that 89 percent of T5 slips contained SINs. A rate of 100 percent is not expected because many recipients are corporations or businesses that do not have SINs or are individuals under the age of 18 years, who are not required to supply a SIN to financial institutions (see Exhibit 18.6).

18.39 While the Department is satisfied with this compliance rate for 1995, it hopes to improve it further by working with financial institutions. Also, Revenue Canada would like the legislation amended to require corporations and businesses to supply their Business Numbers on T5 slips, making possible computerized matching to the Department's business-related databases.

18.40 Just as audit and enforcement benefit from Revenue Canada's supply of information and its compliance research, so do the non-filer and non-registrant programs. The Department now uses data from other federal and provincial government departments to identify specific individuals or corporations who may be non-filers or non-registrants. Revenue Canada will also examine the most recent census information by municipality to determine the degree of non-compliance in different areas of the country — important information for guiding strategy.

18.41 The Department reports that, once identified, 80 percent of non-filers begin to file tax returns voluntarily. It follows up on the remainder and, within three years, almost all file their tax returns voluntarily.

Processing

Continued difficulty in completing reviews of selected returns

18.42 During the 1990s, Revenue Canada significantly restructured its method of processing personal income tax returns. It replaced manual practices with new technologies, and is using different approaches to verifying information reported on returns. In 1995, we reported our concerns about the Department's capability to contain the risks of lost tax revenue in the new returns-processing environment.

Revenue Canada's "confidence 18.43 validity" (CV) program looks at each return and is designed to target the most risky or suspicious returns for manual review prior to initial assessment. A computer selects returns according to criteria known as confidence validities. Because the CV program selects only the most risky and suspicious returns, it is important that all of those be reviewed before the initial assessment. The 1995 audit noted that this was not happening. Moreover, there was no certainty that all returns selected but not reviewed before initial assessment would be reviewed after the initial assessment notice was issued.

18.44 Changes made for the 1995 processing year were meant to ensure that any "high-risk" returns not reviewed before initial assessment would be examined afterward. Revenue Canada monitors returns that are bypassed (selected but not reviewed) at the confidence validity stage. Over the course of the CV program in 1996, over 100,400 returns were selected for review. About 16,700 (17 percent) of those were bypassed for various reasons. The post-assessment review program dealt

with 14,800 of the bypassed returns, leaving 1,900 that were not reviewed at the second stage. Those cases were concentrated in a few taxation centres, and most were not reviewed because staff resources were insufficient to handle the volume of returns awaiting review.

18.45 At a Revenue Canada CV conference in October 1996, it was agreed that workload forecasting would be improved, that tax centres would take steps to improve staffing and training for this program, and that additional resources would be allocated for the 1997 program. Also, in 1997 new weekly reports were provided to help the tax centres manage CV inventories and reduce backlogs. As of 20 May 1997, only 126 of the 34,238 returns processed for the CV program had been bypassed.

In the 1995 audit, we also found 18.46 that the Department had not examined all returns for tax years 1992 and 1993 (only 92 percent in 1992 and 92.9 percent in 1993) that had been chosen for random sampling under the processing review program (a post-assessment verification activity), even though its policy was to review all such returns. This policy is intended to ensure that the results obtained in the processing review program are representative of the underlying populations, given that Revenue Canada relies on this program to estimate the level of voluntary compliance by taxpayers.

18.47 During the 1995 program, 90.5 percent of the returns chosen for the random sample were reviewed. For the 1996 program, 91.9 percent of the returns chosen for the random sample had either been or were being reviewed as at 6 May 1997. Revenue Canada states that some returns were not available for review because they were charged out to other areas such as audit. Certain other cases were not reviewed because of mid-year

adjustments to administrative policies regarding claims to be checked in the Processing Review Program.

It is evident that, in the 1995 and 18.48 1996 random sample program, about the same percentage of selected samples were being reviewed as in 1992 and 1993. While the sample completion rate seems quite high, the uncompleted portion of the sample may have characteristics that are significantly different from the completed portion. Were this to be the case, the conclusions that Revenue Canada drew from analysis of only the completed portion could be seriously in error. To safely ignore the uncompleted portion of the sample, Revenue Canada would have to be sure that its characteristics were essentially no different from those of the completed portion. However, the Department does not have this assurance. Accordingly, we urge the Department to take appropriate action to ensure that all returns chosen for the random sample are reviewed.

Department's comments: The Department remains committed to further improving the review rate for random sampled cases, but 100 percent completion is an unrealistic objective. In large sampling projects, some cases will always be unavailable for review, and the sample design takes this into account. The Department is confident that the completed cases constitute a representative sample. Data from prior years and from the compliance workload are used in sample design and quality checking.

More and better data available but still little analysis of performance

18.49 Our 1995 audit noted the small number of line items (six) selected for review on each return for the 1994 taxation year. Furthermore, it noted that the line items selected varied from one year to the next in both electronically filed

(EFILE) and paper returns, and also varied between paper and EFILE returns. We were concerned that this lack of consistency would impair the Department's ability to monitor trends in voluntary compliance because it would not have sufficient comparable information.

18.50 For the 1995 taxation year, 27 processing review fields were covered in the random sample for paper returns and 24 fields for EFILE returns. For the 1996 taxation year, 24 fields are being covered for paper returns and 21 fields for EFILE returns. This is a substantial increase over the number covered in our 1995 audit of the 1994 taxation year. It will improve the Department's ability to monitor trends in voluntary compliance. The decrease by three in the number of fields being covered for the 1996 taxation year is due to a legal challenge to the taxability of certain income, and to changes in the way certain claims are processed.

18.51 Our 1995 chapter recommended that Revenue Canada use statistics from its compliance monitoring and enforcement programs to analyze trends and patterns of non-compliance. The information could be used in developing criteria for selecting returns to review, and then in evaluating how well the criteria perform. It could also be used to evaluate the overall performance of the new processing regime.

18.52 In 1995, we noted problems in the quality of data from the 1993 processing review program; Revenue Canada subsequently discovered some more problems with the data. The Department postponed much of its analysis while it worked to correct the remaining errors in its data. Aside from data quality, co-ordination problems within the Department have resulted in

delays in generating some of the data needed for analysis.

18.53 Because of these difficulties, the Department has so far performed only a limited analysis of non-compliance trends and patterns using 1994 and 1995 processing review program data. We extended the analysis to 1996 using preliminary data, and found that there does not appear to be any clear trend in non-compliance over the period in the group of data fields available for all three years. However, even the most recent random sample data reveal rather high adjustment rates (exceeding 10 percent) in many fields. In addition, using data from the matching program, the Department found that the average value of adjustments it made to EFILE returns was higher than the average value of adjustments to paper returns for 1994. In particular, adjustments for child care, spousal amounts and other family-related claims were higher for EFILE returns. The reasons for this are not yet fully understood.

Department's comments: The Department acknowledges that the process of extracting, assembling and cleansing the data it needs for analysis has been more time-consuming than expected. However, these preparatory steps are essential to effective analysis and decision support in any business context.

At this time, no definite conclusion can be reached about hypothetical differences in the compliance rates for EFILE and paper returns. Data being gathered via the random samples for the years 1995 and 1996 will enable valid trend analysis. Since the EFILE and paper returns covered by the Matching program are not based on equivalent geographical areas, the adjustment rates are not comparable. No inference can be drawn about the rates that might apply to other deduction or credit items.

The Department has so far performed only a limited analysis of non-compliance trends and patterns using 1994 and 1995 processing review program data.

Revenue Canada reduced its comparable inventory of unprocessed pension plan files from 24,028 in June 1994 to 8,732 by 24 March 1997.

Our analysis during our 1995 18.54 audit revealed that the scoring system used by the Department to evaluate the riskiness of returns was weak and needed improvement. Our updated analysis of the scoring system in place during the 1996 program year also indicated room for improvement. However, we are encouraged by the Department's recent development of new scoring criteria based on statistical analysis of program data. The new criteria have been implemented in 1997. In addition, the Department has been experimenting with other techniques - referred to as "neural networks" - that may serve as a complement to the kind of scoring system now in use.

Regarding evaluation of the 18.55 overall performance of the new processing regime, the Department has drafted an evaluation framework that proposes some useful indicators of program effectiveness. However, we believe that the framework can be improved. Clear measures need to be defined to evaluate such questions as whether the proper levels of resources are being devoted to paper and EFILE reviews, whether the mix between CV reviews and processing reviews is appropriate, and what fields should be subject to review. It would also be appropriate to define a timeline that shows when the various aspects of the evaluation would be done.

Department's comments: The Department appreciates the suggestions for improvement included in this paragraph and will incorporate them in its evaluation plans.

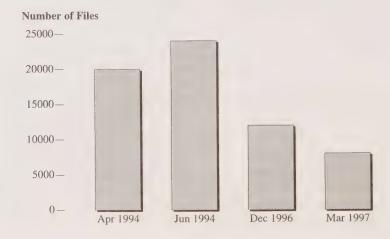
Backlog of unprocessed pension plan files is declining

18.56 Our 1994 chapter on tax-assisted retirement savings pointed to severe delays and backlogs in registering and approving amendments to pension plans. We reported that 20,105 files were awaiting processing as at 1 April 1994; this number increased to 24,028, its highest level, in June 1994. Thanks to a number of measures, Revenue Canada had reduced its comparable inventory of unprocessed files to 8,732 by 24 March 1997 (see Exhibit 18.3).

18.57 To achieve the reduction, the Department hired more staff and changed the staff mix to match the composition (in terms of complexity) of the files examined, improved work flows, used assessments of risk to guide the review process, and transferred the review of wind-up and conversion reports to a desk audit program that is done at a later time. Revenue Canada also consulted with pension industry representatives to come

Exhibit 18.3

Pension Plan Files Awaiting Processing



Source: Revenue Canada

up with plan prototypes in an attempt to improve the quality of documents submitted to the Department for review.

At 1 April 1994, 40 percent of the unprocessed pension plan files were more than six months old; by 24 March 1997, this had decreased to 27 percent. The Department's current published standards for registration or termination of a pension plan is 180 days. However, the Department believes this is an inappropriate standard to apply to pension plan amendments, which it says make up the majority of the unprocessed files. Revenue Canada intends to soon publish a less demanding standard for amendments, in recognition that these are lower-priority items. Good progress has been made in processing pension plan files.

Collections

New system for income tax accounts receivable to be used for other taxes

18.59 Our 1993 audit observation on overdue GST, our 1994 chapter on collecting income tax debts, and our 1995 chapter on the air transportation tax each dealt with collecting tax debts. The 1994 chapter dealt with the topic in most depth and will be the focus of this section.

However, given that the collection function has been significantly affected by the administrative consolidation of the former departments of Taxation and Customs and Excise to form the present Revenue Canada, our comments on the current collection regime generally apply to all types of tax debts.

Growth in accounts receivable. When we published our 1993 audit observation, the GST had been in place for just over two years. Accounts receivable were increasing and had reached \$650 million by March 31 of that year. But given that there were also 576,000 registrants who were delinquent in filing returns, the accounts receivable balance was likely understated. Indeed, GST accounts receivable have continued to rise, totalling \$1.6 billion by the end of the 1995-96 fiscal year. Exhibit 18.4 shows how unpaid GST has increased each year while unpaid income tax debts have tended to level off over the last few years.

18.61 In 1994, we reported that unpaid income tax debts had grown from \$4.2 billion in 1988–89 to \$6.6 billion in 1993–94, an increase of 58 percent. Over the same period, net federal income tax revenue had grown from \$70.6 billion to

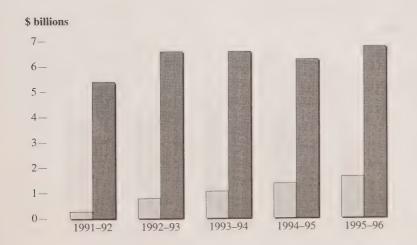


Exhibit 18.4

Unpaid Income Tax and GST
1991–92 to 1995–96

GST
Income Tax

It is hard to point to evidence that the changes in the collections program are having an impact. Nevertheless, we feel the changes make sense and should prove to be beneficial.

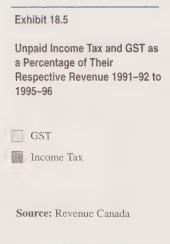
\$80.4 billion, an increase of 14 percent. Thus, the growth in unpaid income tax debts outpaced the growth in net federal income tax revenue. Our follow-up noted that by the end of fiscal year 1995-96, unpaid income tax debts had increased by another 3 percent to \$6.8 billion, while net federal income tax revenue had increased by 20.3 percent to \$96.7 billion. This means that growth in unpaid income tax debts was now slower than growth in net federal income tax revenue. Exhibit 18.5 shows that the percentage of unpaid income tax debts to income tax revenue has decreased since 1993-94, while the percentage of unpaid GST to GST revenue has increased each year.

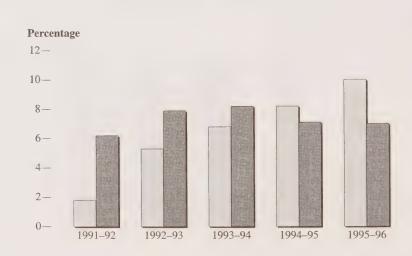
18.62 Changes to the collection regime. The 1994 chapter criticized certain aspects of Revenue Canada's collection regime. We stated that the Department could improve its collection performance by changing the way it judged the riskiness of a delinquent account and by tailoring its collection procedures for a particular account according to that risk. We also noted areas where we felt management's monitoring of the performance of the collection function could be improved.

After visiting private industry and 18.63 upon completing a benchmarking process, the Department developed and tested a risk analysis system that can classify accounts receivable according to compliance patterns or potential for loss. This system has been implemented for individual income tax accounts, with the intention of also incorporating payroll deductions, corporate income tax, GST, customs and excise accounts in the future. The system will operate by directing accounts to the most efficient recovery process to be used — whether written notices, call centre reminders or more intense collection action by staff in one of the Tax Services Offices (TSOs).

18.64 In addition, 11 of the larger TSOs began the practice of making early contact with taxpayers on accounts over \$100,000. During 1996–97, of 1,350 accounts on which early contact was made, 341 were paid in full and a total of \$181 million was collected (see Exhibit 18.6).

18.65 An on-line collections manual is now in place, combining policies and procedures for GST and income tax. It includes standards for assessing, documenting and verifying information pertaining to debtors' ability to pay, and





standards of performance by collectors for such things as nature and frequency of debtor contacts, time frames for resolving accounts and use of legal action. All these standards are monitored by departmental headquarters. **18.66** Except for the results from early contact on large accounts, it is hard to point to evidence that the changes in the collections program are having an impact. Nevertheless, we feel the changes make sense and should prove to be beneficial.

Exhibit 18.6

Examples of Follow-up on Our Recommendations, PAC Reports, Revenue Canada Initiatives and Progress Made

Topic	OAG Recommendation	Public Accounts Committee Report/ Recommendation	Revenue Canada Initiative	Progress
Social Insurance Numbers	Continue initiative to obtain social insurance numbers for those information slips pertaining to individuals. Investigate other options, including reconsidering a withholding requirement, in cases where a valid SIN is not provided and recommend legislative changes.	Department should report to the Committee stating whether various objectives have been achieved. For example, the target for 1995–96 fiscal year for getting SINs on T5s issued by financial institutions is 90 percent.	The Underground Economy Initiative focusses on non-compliance by • possible reporting and information changes, including steps to improve reporting of SINs on the T5 slips.	 For the 1996 processing year, the SIN compliance rate on T5 slips was 89% Department will continue to work with the financia institutions to ensure a greater level of compliance in SIN reporting. Legislation changes requested, which are currently being studied by the Current Amendments division.
Collection Procedures	Collect on large debts soon after they become due.	 Expected Department to be fast-tracking the collection of large debts. Early systematic contact with the taxpayer allows for assessment of danger of loss and negotiation of payment arrangements. 	 Monitor large debtors for danger of loss Test effectiveness of contacting taxpayers for voluntary payment prior to the date on which enforced collection action may begin. 	 Early contact on large accounts (over \$100,000) implemented in 11 Tax Services Offices. During 1996–97 contact made on 1350 accounts, 341 accounts paid in full, a total of \$181 million collected.
Fairness Package	 Track requests and decisions granted under the Fairness Package. Monitor circumstances in which adjustments made. Develop policies and practices for use of the Fairness Package. Monitor the effects on taxpayer compliance. 	 Concerned that the Department could not determine the total value of reassessments made under the Fairness Package since 1991. Concerned there were insufficient guidelines ensuring uniform application of the Package. 	 Annual report giving the cumulative total of all decisions made under the Fairness Package. Procedures designed to increase uniformity to be in effect no later than August 1995. 	 April 1,1996, tracking fairness decisions and amounts forgiven, including breakdown by reason of cancellation. Distributed guidelines for use of fairness package and tracking system. National Fairness Committee established to co-ordinate fairness issues.

Revenue Canada
established the
Compliance Research
Directorate to act as a

centre of expertise on

risk assessment and

risk management.

Better control over use of the "Fairness Package"

18.67 In 1994, we were concerned about poor control over the use of the "Fairness Package" legislation, which provides the Minister with discretionary power to waive all or a portion of interest and penalties. We noted deficiencies in the Department's policies governing the use of the Fairness Package, in its ability to track requests for relief and decisions granted under the Fairness Package provisions, and in its ability to monitor the circumstances in which the Fairness Package was applied.

18.68 Subsequently, the Department developed enhanced guidelines on applying the Fairness Package and released them in a policy paper entitled "Application of the Fairness Provisions to Interest and Penalty". A registry and reporting system was implemented to track fairness decisions and account for amounts forgiven under the fairness provisions, including the breakdown of such amounts according to the reason for forgiveness (see Exhibit 18.6).

Audit and Enforcement

Compliance research leads to new audit tools and techniques

18.69 Audit and enforcement are labour-intensive elements of tax administration. Revenue Canada can reach only a small fraction of taxpayers, registrants and others through audit and enforcement. The Department must direct its efforts to the members of the population who pose the highest risk of non-compliance, who represent a significant source of revenue leakage, and against whom enforcement efforts will deter others from non-compliance. To accomplish this, the Department needs

sound compliance research to understand the characteristics of that population.

established the Compliance Research Directorate to act as a centre of expertise on risk assessment and risk management. The Directorate monitors trends in revenues, examines compliance patterns, and conducts studies of factors that affect compliance. The results help in the formulation of compliance strategies and in the creation of computerized tools with which auditors can select the most promising targets for examination and focus on areas that are most likely to reveal non-compliance.

18.71 In response to a recommendation in our 1994 chapter on tax-assisted retirement savings, Revenue Canada set up a system to collect data on the results of its front-end compliance reviews of money purchase and defined benefit pension plans. Analysis of the data showed that certain money purchase plans were low-risk. The Department then adjusted its review process to focus more of its efforts on the high-risk plans. This is an example of how compliance research can improve audit and enforcement.

Auditors adopt focus on industry sectors

of audit and enforcement demand substantial amounts of good information about taxpayers, registrants and others. The risk of tax revenue leakage varies across industry sectors, which means that industry-sector-based information is essential for risk assessment and risk management. Our 1994 audit of GST audit and special investigations revealed that Revenue Canada possessed poor quality and insufficient quantities of information on registrants — in particular, incomplete and unreliable records of

registrants' Standard Industry Classification (SIC) codes.

18.73 In 1995, the Department mounted a project to review the records that were missing SIC codes for registrants. Now, it reports that 95 percent of accounts of registrants whose annual taxable sales exceed \$30,000 (the threshold for mandatory registration) contain a proper SIC code. In addition, auditors are now responsible for adding missing SIC codes when they make an examination. Revenue Canada and Statistics Canada have established a committee to address the need to ensure that SIC codes reliably describe different industry sectors.

18.74 Further improvements in taxpayer/registrant information are on the horizon. Revenue Canada has introduced a common identifier, known as the Business Number, for all corporate income tax, employer payroll source deductions, GST and customs accounts. Having a common identifier should soon make it practical for the Department to draw upon much more of its information — stored in separate computer systems — for use in compliance research or audit selection. A computer-assisted system for selecting GST registrants for audit is now in place. The system uses information from various sources inside and outside the Department.

18.75 The Department is moving away from an audit selection strategy focussed on identifying individual taxpayers/registrants to a strategy focussed on industry sectors. The Department analyses non-compliance by sector or occupation to identify high-risk areas and to develop appropriate actions. Its Underground Economy Initiative, for example, concentrates on the sectors of construction, jewellery, automobile sales

and repairs, hospitality, and home renovations.

18.76 Tax Services Offices (TSOs) are setting up teams of auditors, each team to specialize in dealing with a limited number of sectors. In hand with this, an industry sector specialist team of professionals is putting together "sector profiles" containing business, economic, technical, and compliance information relevant to auditors. Drawing upon the experience of TSO staff in this way responds to one of the recommendations we made in 1994.

18.77 Not all of Revenue Canada's efforts to improve audit selection rely on using computerized systems. Auditors in the Registered Plans Division make use of referrals from, and consultations with, staff of various sections within the Division to identify areas where risk of non-compliance is high.

New strategies aim at improved audit coverage

18.78 Our 1994 chapter on GST audit and special investigations observed that the number of audits carried out was low — lower than the Department had planned. We recommended that enforcement efforts be made more visible.

18.79 Since its administrative consolidation, Revenue Canada reports its performance for all its verification and enforcement programs together. The Department's 1995-96 Performance Report shows an increase in enforcement resources to 6,871 full-time-equivalent staff, from 5,909 in 1992-93. Over the same period, the Department reports that the total fiscal impact of verification and enforcement activities increased from \$3.64 billion to \$4.48 billion. The Department defines "fiscal impact" as federal and provincial tax (where applicable), federal tax refunds offset or

The Department is moving away from an audit selection strategy focussed on identifying individual taxpayers/registrants to a strategy focussed on industry sectors.

reduced, interest and penalties, and the present value of future tax assessable.

18.80 Revenue Canada is trying to take advantage of administrative consolidation to increase audit visibility and coverage. It is following a strategy whereby auditors who examine a taxpayer/registrant selected for audit of either GST or income tax will review key indicators of performance for the other tax as well. For the very large companies that are subject to Revenue Canada's Large File Program, an audit of both income tax and GST is done where, in the judgment of the Large File Case Manager, it is warranted.

The Department has increased its audit coverage of registered pension plans.

18.81 In 1994, we also reported that audit coverage of registered pension plans was too low to detect and deter non-compliance. Since then, the Department has increased the number of audits it performs from 127 in 1992–93 to 365 in 1996–97. To attain even wider coverage, Revenue Canada is looking into the possibility of co-operating with the Pension Commission of Ontario to perform joint audits.

18.82 In response to our observation that past service pension adjustments (PSPAs) were not systematically verified, Revenue Canada performed a study to determine the need for a PSPA examination program. It found that a program was needed and has trained staff in order to implement it in 1997–98.

18.83 Tax evasion. Taxpayers are entitled to use legal means to reduce the amount of tax they pay. But when they use illegal means — fraud — to escape paying tax, they are guilty of tax evasion. Out of fairness to the great majority of individuals and businesses who voluntarily comply with the tax laws, Revenue Canada investigates and prosecutes those who are suspected of tax evasion. It also publicizes its successful

prosecutions as assurance to honest taxpayers and as a warning to others.

investigations and detection of non-filers noted the Department's concern that the number of referrals to Special Investigations of cases of suspected income tax evasion was much lower than desired. The same year, our chapter on GST audit and special investigations remarked that referrals to Special Investigations of suspected GST evasion cases, although numerous, were of low quality — lacking the substance needed if they were to be developed for prosecution.

18.85 To address these problems, Revenue Canada has given fraud awareness training to more of its auditors and has published additional guidance to auditors on preparing referrals.

Verification program for RRSP contributions needed

18.86 In our 1994 audit of tax assistance for retirement savings, we made a recommendation with which Revenue Canada disagreed at the time and on which it has taken no action.

18.87 We were concerned that taxpayers might make invalid claims for RRSP deductions and that Revenue Canada did not possess information from an independent source that could be used to check for invalid claims. In addition, we were concerned that Revenue Canada had no way to detect taxpayers who attempted to defer tax by sheltering income in an RRSP even though they had not claimed a deduction, perhaps because they had made contributions in excess of allowable limits.

18.88 The Department points out that starting in the 1994 taxation year, taxpayers are required to make additional disclosures on their income tax returns. However, we do not believe that this is an

adequate substitute for a verification program aimed at RRSP contributions. We hope the Department will reconsider its position and implement a verification program for RRSP contributions.

Policy and Legislation

Process developed to manage the risk associated with complex legislation

18.89 In 1993, we reported on the use of a resource allowance income tax provision that Revenue Canada estimated could cost \$1.2 billion in lost tax revenue. Revenue Canada had challenged one taxpayer's interpretation of the provision in the courts in the belief that its own interpretation would prevail and the threat to the tax base would be eliminated. However, the courts found in favour of the taxpayer. We pointed out that if the government had moved quickly to clarify the law, a considerable portion of this loss could have been prevented.

18.90 Our observation resulted in an inquiry by the Public Accounts Committee into the government's procedures for managing the risk to the tax base associated with complex legislation. The inquiry was completed and the Committee presented its recommendations to the House in February 1995. In response to the Committee's recommendations, the government has developed a process to act more quickly and reduce the likelihood of similar losses in future.

Issue relating to condominiums has been resolved

18.91 In 1994, we reported that Revenue Canada had failed to resolve an issue that we had first raised in 1992, concerning the ability of condominium corporations to earn tax-free interest income for the benefit of individual condominium owners. Our concern was

that this ability arose from an administrative policy established by the Department, and this ability was not available to owners of other types of residential dwellings.

18.92 Revenue Canada has studied the matter and found that the administrative policy was not necessary, since condominium corporations can qualify as non-profit organizations. The information setting out the Department's administrative policy has been cancelled.

Basis for sharing "unapplied taxes" with the provinces and territories not resolved

18.93 In a 1993 audit observation, we reported our concern that payments to provinces and territories participating in the Tax Collection Agreements were being understated because of Revenue Canada's failure to share the balance in one of its accounts.

18.94 Concerned that the balance in the account may have arisen, in part, from bookkeeping errors and therefore was not appropriate to share, Revenue Canada made a significant effort to ensure that only appropriate transactions were recorded in the account. This having been done, the question remains whether the balance in the account ought to be shared.

18.95 It is Revenue Canada's and the Department of Finance's view that only unapplied amounts deducted from employees' earnings are to be shared with the provinces and territories. We believe that the account in question may contain such amounts as well as other amounts that the provinces and territories may regard as shareable.

18.96 We understand that this issue will be discussed with the provinces and the territories in the near future.

Monitoring and Reporting

Management information agreements promise better monitoring and reporting

Another common theme in many 18.97 of the audits we followed up was the need for Revenue Canada to collect information that would tell management how the Department is performing in relation to its goals, and that could be used to report to Parliament on how Revenue Canada is fulfilling its mandate. In addition to meeting its own management information needs, Revenue Canada has to supply the Department of Finance, as the steward of tax policy, with the information it needs to judge how well the tax system is achieving the policy objectives it serves. A prime example is information needed to monitor the effectiveness of tax expenditure programs.

18.98 In 1994, we reported the results of our audit of income tax incentives for research and development. We found that Revenue Canada was collecting some, but not all, of the information needed to monitor the incentives for research and development. We also observed that the Department's database on the scientific research and experimental development incentive was not completely reliable.

18.99 In response to the first problem, Revenue Canada modified its Audit Information Management System to capture additional kinds of data. It has also specified features that are to be built into a new system being developed to process corporate income tax returns. Regarding the second problem, the Department has instituted new verification procedures aimed at improving the accuracy and completeness of the information in its scientific research and experimental development database.

18.100 More generally, the Department's Verification, Enforcement and Compliance Research Branch developed management information agreements for each program in the Branch. The agreements define program mandates, objectives, and performance indicators along with the data required to produce them. In addition, the Branch publishes and widely distributes to its staff a volume covering its priorities and achievements, and program information.

Trade Administration

18.101 Canada's trade relations are affected by many government policies and international agreements to which it is a party. Revenue Canada plays a major role in the administration of these policies and agreements. There are many parallels between Revenue Canada's activities in tax administration and those in trade administration.

18.102 In this section, we report the results of our follow-up of our 1994 chapter on customs assessment. That chapter approached trade administration from the standpoint of the assessment of customs duties, including the administration of duty-relief programs. The approach was consistent with the Department's emphasis at that time on revenue generation as part of the government's overall strategy of deficit reduction. It is noteworthy that now, roughly three years later, the emphasis has shifted more toward improving trade data in support of the government's trade development initiatives, one of the Department's concerns even in 1994.

Periodic verification initiative is progressing

18.103 In 1994, we reported that Revenue Canada had recently completed two pilot projects that, among other things, tested the use of periodic

verification as an alternative to ongoing review of imports by large importers. Satisfied with the merits of the periodic verification alternative, the Department came up with a plan to audit 128 large and medium importers from 27 industry sectors. As of December 1996, 27 audits had been completed, 68 were under way, and 33 had not begun. The program is to cover 32 percent of the total import value for duty.

18.104 As a complement to on-site periodic verification of importers, Revenue Canada envisages doing a less extensive desk verification of enough other importers to bring the coverage up to 40 percent of total value for duty of imports. This work has yet to begin. In the longer term, the Department intends to identify other industry sectors for review, based on its own research and on Canada's international business development plan.

End-use and country-of-origin audit concerns have been addressed

18.105 An end-use provision reduces or eliminates the duty payment if certain conditions are met. In 1994, we were concerned that not enough end-use audits were being done. A new tariff scheduled for implementation on 1 January 1998 will greatly reduce the number of end-use codes and thereby reduce the need for end-use audits. In the meantime, Revenue Canada has reorganized the end-use audit function and has tied it to the periodic verification initiative. It believes those actions have improved the scope and effectiveness of these audits.

18.106 We expressed similar concern about the low number of country-of-origin audits. These are audits to determine that

a country from which goods originate is entitled to a preferential tariff rate under a free trade agreement. By increasing the number of staff devoted to country-of-origin audits, Revenue Canada has been able to increase the number of audits it performs. In 1994, we reported that the Department had carried out 40 audits in the five years ending 31 March 1994. Departmental records show that in the three subsequent years it completed 36 audits.

Small importer strategy formulated and implementation started

18.107 Ninety-one percent of importers account for just 6 percent of the total import value for duty. They tend to import goods less than once a week. The risk is low that any errors by these small importers would significantly distort trade data.

18.108 Our 1994 chapter noted that Revenue Canada's New Business Relationship (NBR) initiative was heavily focussed on large importers, and that a strategy was needed to deal with other importers. Believing that it would be inefficient to apply a periodic verification strategy to small importers, the Department has chosen instead to use a client service strategy as part of the NBR initiative, involving simplified trade data requirements, easier payment terms and methods, wider access to electronic commerce, and more effective programs of client assistance and information. To date, the client service strategy for small importers has been developed and the Department reports that supporting initiatives are to be undertaken during 1997-98.

Satisfied with the merits of periodic verification, the Department is in the process of auditing 128 large and medium importers from 27 industry sectors.

The Department of

report on an

evaluation of the

and experimental

development.

Finance is finalizing a

income tax assistance

for scientific research

DEPARTMENT OF FINANCE

Observations

Tax Assistance for Retirement Savings

18.109 The Department of Finance is responsible for the design and management of the program of tax assistance for retirement savings (TARS). Management of the program involves monitoring, evaluating and reporting on its costs and effectiveness, and recommending changes as appropriate.

Improved cost estimates are expected

suggestion that it provide information on the estimated costs, results and workings of the TARS program, Finance says that it will be providing historical data and a five-year forecast of the tax expenditure in an upcoming tax expenditure report. We also advocated supplementing cash flow estimates of the tax expenditure with estimates based on the present-value method and other approaches. The Department has made present-value estimates of the cost of the TARS program, which it has submitted for review by experts from outside Finance.

Slow progress on evaluation studies

18.111 In 1994, we noted the Department's plan to complete nine evaluation studies of the TARS program. It has since changed its plan. Four of the proposed studies are being combined into one and a preliminary report is expected at the end of the summer, along with a report on a survey of compliance issues. Work on the other four studies is to begin in the fall.

18.112 Our remaining recommendations had to do with conducting further evaluation studies that were not planned at the time of our audit. Finance tells us that these are being addressed in part and that we will be given the results of this work in the future.

Income Tax Incentives for Research and Development

Evaluation studies and cost estimates are forthcoming

18.113 This 1994 chapter also focussed on Finance's role in monitoring tax incentives for scientific research and experimental development (SR&ED) and in accounting for their costs. We saw a need for more thorough and systematic monitoring to allow for better accounting of projected and actual costs and results.

18.114 The Department indicates that it is now finalizing a report on the findings of an evaluation of the income tax assistance for scientific research and experimental development. In addition, in the upcoming report on tax expenditures it will be publishing estimates and forecasts of the costs of the SR & ED tax credits.

Other Observations

Technical deficiencies in law related to foreign affiliates and taxpayer migration corrected

18.115 In our 1992 Report, we observed that tax arrangements for foreign affiliates were costing Canada hundreds of millions of dollars in lost revenues. After a detailed inquiry, the House of Commons Standing Committee on Public Accounts submitted recommendations to the Minister of Finance in April 1993. The February 1994 Budget announced changes to the rules governing the way foreign affiliates are taxed. The amendments, now in law,

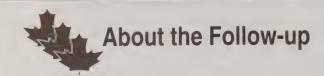
incorporate most of the recommendations of the Public Accounts Committee.

18.116 In May 1996, we reported serious concerns about the administration of the Income Tax Act involving the tax-free movement out of Canada of at least \$2 billion in assets held in family trusts. This report generated a great deal of attention by the government and by two committees of the House of Commons. In response to House of Commons Finance Committee recommendations, in October 1996 the Minister of Finance announced major changes to the income tax rules for persons (including trusts) who leave Canada. The proposed changes are intended to ensure that taxpayers who move or transfer property from Canada will remain subject to Canadian tax on their capital gains. In making the announcement, the Minister acknowledged the Auditor General's role in drawing attention to the issue and the Finance Committee's role in recommending corrective action. He said, "This is a textbook case of the system working as it should."

18.117 In 1994, we reported that a number of companies in the financial sector had made claims under the scientific research and experimental development (SR & ED) provisions of the Income Tax Act, amounting to over \$300 million. The claims were for software development, and it was unclear whether the SR&ED provisions were meant to apply to this kind of item. At one point, the Minister of Finance produced draft legislation aimed at denying claims for software developed by companies in the financial sector. The draft legislation was later withdrawn in favour of administrative action by Revenue Canada to deny such claims.

18.118 Our 1995 chapter on the air transportation tax drew attention to a possible loophole involving charter air transportation and suggested that Finance may need to re-examine the legislation. In connection with the privatization of Canada's air navigation system, Parliament has since passed legislation that will abolish the air transportation tax in the fall of 1998. In view of this development, we expect no further action by Finance on this matter.

In October 1996 the Minister of Finance announced major changes to the income tax rules for persons (including trusts) who leave Canada.



Objective

To assess, for 15 audits conducted between 1992 and 1996, the extent to which OAG recommendations, applicable Revenue Canada action plans and PAC recommendations have been addressed by Revenue Canada and the Department of Finance.

Scope

We followed up on the 15 audits listed below, related PAC recommendations, and applicable departmental action plans.

1992	Chapter 2	Audit Note on Tax Arrangements for Foreign Affiliates* 3
1993	Chapter 3	Audit Note on Resource Allowance Income Tax Provision *1
	Chapter 3	Audit Note on Tax Collection Agreements ²
18 × 185	Chapter 3	Audit Note on Overdue GST ¹
	Chapter 20	Advance Income Tax Rulings: GST Rulings and Interpretations ¹
1994	Chapter 3	Audit Note on Condominium Corporations ¹
	Chapter 28	Customs Assessment Activities 1
	Chapter 29	Collecting Income Tax Debts (PAC 8th Report) 1
	Chapter 30	GST: Audit and Special Investigations (PAC 8th Report) 1
	Chapter 31	Ensuring Fairness of the Income Tax System: Detection of Non-Filers and Special
	·	Investigations (PAC 8th Report) 1
	Chapter 32	Income Tax Incentives for Research and Development (PAC 9th Report) ²
	Chapter 33	Tax Assistance for Retirement Savings (PAC 9th Report) ²
1995	Chapter 16	Air Transportation Tax ²
	Chapter 25	The New Regime for Processing Income Tax Returns ¹
1996	Chapter 1	Audit Note on Moving Assets out of Canada* 3
	1. y	त्या । कार प्राप्त कार अवसुत्र कार प्रकृतिक में मुद्दाहरू अस्ति कार प्राप्त कार प्राप्त कार प्राप्त कार प्राप्त

- 1 These audits involved follow-up in Revenue Canada only
- ² These audits involved follow-up in Revenue Canada and the Department of Finance
- ³ These audits involved follow-up in the Department of Finance only.

Approach

Revenue Canada and, where applicable, the Department of Finance provided status reports presenting management's assessment of the departments' progress in implementing their action plans and in responding to our recommendations and those of the PAC for each of 12 audits. We used the status reports as a base to carry out the follow-up. For the other three audits*, we did not request status reports but followed up on actions taken by performing review procedures ourselves.

In order to draw conclusions about the plausibility of management's assertions contained in the status reports, we collected data on a selective basis and performed other review procedures.

Follow Up Team

Michael Adibe Nabi Baksh John Pritchard

For information, please contact Jim Ralston, the responsible author.



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Chapter 19

Transport Canada

The Commercialization of the Air Navigation System

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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Assistant Auditor General: Shahid Minto Responsible Auditor: Hugh A. McRoberts

Transport Canada

The Commercialization of the Air Navigation System

Main Points

- 19.1 On 31 October 1996, in exchange for a payment to the Crown of \$1.5 billion, a substantial legislated monopoly in perpetuity for the operation of Canada's civil air navigation system was transferred to NAV CANADA, a private not-for-profit corporation created in 1995 to receive and operate the system.
- 19.2 Transport Canada did not fully segregate the air navigation system elements that were to be privatized before entering the sale process. It developed a number of estimates of the system's value, but did not obtain a formal valuation opinion from a qualified independent professional. Nor did it obtain any external assurance as to the reliability of the financial information and results on which it was basing its decision on the sale.
- 19.3 The Department used both going-concern and net book value approaches to valuing the system. Although the air navigation system was sold as a going concern, the Department reconciled the "purchase price" to a valuation of the system based on an "adjusted" net book value. In our opinion, that was not an appropriate method of valuation in these circumstances. "Due regard to economy" does not mean that the purchase price must equal the valuation; but it does mean that the value must be known and that any difference should be explained.
- 19.4 The government had directed Transport Canada to receive fair market value for the transfer of the air navigation system to a not-for-profit entity; the Department agreed to transfer the air navigation system for a negotiated payment of \$ 1.5 billion, approximately \$1 billion less than the entity's going-concern value of \$2.4 billion estimated by the Department's financial advisors.
- 19.5 The costs of transferring the air navigation system to the not-for-profit corporation were significant. Nevertheless, Transport Canada did not identify separately the cost associated with pension transfers, currently estimated at between \$145 million and \$275 million.
- 19.6 We are concerned about the Department's lack of justification for entering into a sole-source contract with its principal financial advisor.
- 19.7 We audited some elements of Transport Canada's oversight of the air navigation system. We did not audit the safety of the system and provide no opinion on it. We found that the legal and regulatory foundations for the regulation of NAV CANADA have been established and the Department has very recently approved its Policy Framework for the Safety Oversight of Canada's Air Navigation System. Nonetheless, there are important matters of risk, data, and audit and inspection that must be resolved before Transport Canada's regulatory regime can be said to be fully operating. The Department is aware of these issues and is in the process of drafting action plans and taking steps to deal with them.
- 19.8 We are concerned that until Transport Canada makes significant progress in implementing its performance-based regulatory regime, it will not be in a position to have full assurance of NAV CANADA's compliance with the safety regulations governing the air navigation system. Although it has indicated that it would be aware of any problems that existed, the Department has yet to conduct its first audit or inspection of NAV CANADA's operations.



Introduction

19.9 On 31 October 1996, in exchange for a payment to the Crown of \$1.5 billion, the operation of Canada's civil air navigation system was transferred to NAV CANADA — a private not-for-profit corporation created to purchase and operate the system. NAV CANADA is to operate independently of the government except for certain clearly defined areas such as safety and services to remote and northern communities, and is intended to become financially independent of the government after two years. This transaction was authorized by the passage in June 1996 of the Civil Air Navigation Services Commercialization Act.

19.10 In the past, two major transportation Crown corporations — Air Canada and Canadian National Railways — were privatized through stock flotations. However, this was the first time that a major operational arm of a government department was transferred by private contract. This was a large and complex transaction involving significant amounts of money and was done in a relatively short time. Given the unusual nature of the transaction and the likelihood that other divestitures may occur in the future, we decided to report on it.

The civil air navigation system

19.11 The civil air navigation system provides civil air traffic control, flight information services such as weather briefings, and a network of navigational aids. Collectively, the various elements of the system provide for the safe and orderly flow of aircraft in Canadian airspace and in those parts of international airspace for which Canada is responsible. Air navigation services are delivered through area control centers, air traffic control

towers, flight service stations and a national radar and communications system.

Decision to divest

19.12 On 22 February 1994, the federal Budget included a proposal to study the commercialization of the air navigation system. During the ensuing year, the Department prepared a series of consultation documents and, working with affected government departments, held consultations with all sectors of the aviation community. As the consultations progressed, the option increasingly favoured was the transfer of the system to a not-for-profit corporation that would be created to operate it.

19.13 In the 27 February 1995 Budget, the Minister of Finance announced the government's intent to proceed with the commercialization of the air navigation system. Transport Canada was to achieve this result by as early as possible in the 1996–1997 fiscal year. Initially, 1 April 1996 was set as the target.

Transport Canada's Commercialization Model

Birth of the not-for-profit corporation

On 26 May 1995, NAV 19.14 CANADA, a private not-for-profit organization, was incorporated under Part II of the Canada Corporations Act as a non-share capital corporation. By-laws were drafted to establish the new entity's corporate structure and governance requirements following the government's direction. Transport Canada entered into reimbursement agreements with NAV CANADA, specifying that if the transaction was not successful, the government would become liable for the purchaser's eligible expenses. The agreements ended on the transfer date and the costs incurred were borne by NAV CANADA.

This was the first time that a major operational arm of a government department was transferred by private contract.

The Government of Canada continues to have a significant role in the air navigation system.

The international aviation community is watching the Canadian experience with interest.

Accountability and corporate 19.15 governance. NAV CANADA's incorporation documents established the legal and accountability framework for its governance. It was formed with four members: one appointed by the federal government, two appointed by user groups, and one appointed by the unions representing air navigation system employees. Corporate governance is exercised through a 15-member Board of Directors; 10 are nominated by the four appointed members forming the corporation and they, in turn, nominate five more, one of whom is the President. The Board's members cannot be active government officials, politicians, significant suppliers, clients or users of the system.

19.16 Role of the federal government. The Government of Canada continues to have a significant role in the air navigation system. It is responsible for regulating it and overseeing its safety. It may also review changes in revenue structure and rates, and it is responsible for deciding on northern and remote services, and appointing a member to the corporation.

19.17 Monopoly. The Civil Air Navigation Services Commercialization Act provides NAV CANADA with a substantial legislated monopoly over the provision of civil air traffic control services and aeronautical information services in perpetuity, as long as it meets its obligations under the Act. In return, it is expected to offer these services in a safe and efficient manner that meets the needs of Canadians and fulfils Canada's international obligations.

19.18 Financial independence. NAV CANADA is financially responsible for the operation, maintenance and capital requirements of the Canadian air navigation system. To that end, the legislation gives NAV CANADA the right

to recover all of its costs through user charges. The primary sources of revenue for the system when it was operated by Transport Canada were the Air Transportation Tax and, since November 1995, international overflight charges. By the end of the second year after transfer, NAV CANADA is to have introduced terminal charges and domestic en route charges in addition to increasing international overflight charges. The government provided for monthly grants to a maximum of \$ 1.44 billion to be paid to NAV CANADA during the first two years until it has put its charges in place. These grants are approximately equal to the government's anticipated revenues from the Air Transportation Tax. As NAV CANADA introduces its charges, the government is expected to revise the ticket tax rate until the end of the second year after the transfer, at which time it will be repealed.

19.19 Transport Canada's model is unique. Other countries have moved in the direction of separating the operation of their air navigation systems from government. Some, most notably Australia and New Zealand, have gone so far as to set up the air navigation system operator as an entity similar to a Crown corporation. The United Kingdom has also set up a separate air navigation service organization and plans to privatize it in the near future through a stock flotation.

19.20 At the time of writing, however, Canada is the only major country to have taken the extra step of transferring the operation of its air navigation system to the private sector. The international aviation community is watching the Canadian experience with interest.

Objectives for commercialization

19.21 According to Transport Canada, the government's objectives in commercializing the air navigation system

were to have a system able to respond better and more quickly to user needs, to achieve more rapid system improvements in internal and transportation efficiency, to eliminate the system's dependency on taxpayers and to operate the system in a businesslike way.

Timetable for transfer

In November 1995, following negotiations during the early fall, the government approved the transfer of the right to operate the civil air navigation system to NAV CANADA for a payment of \$1.5 billion. A broader agreement-inprinciple for the transfer was reached on 8 December 1995 and the agreement to transfer was finalized on 1 April 1996. Although several delays were encountered during the sale process due to the complexity of the transaction, on 31 October 1996 the government received a payment of \$1.5 billion and transferred the operating rights and assets of the civil air navigation system to NAV CANADA. Due in part to the speed with which the process was accomplished, a series of undertakings by Transport Canada remained to be done — among other things, to identify and transfer all relevant items of intellectual property, to complete the conveyance of lands, and to complete the assignment of contracts. Exhibit 19.1 shows the timetable of the commercialization process.

Focus of the Audit

19.23 Details on our scope and audit objectives are included in the section About the Audit at the end of the chapter. We did not audit the decision to transfer or look at the negotiation process, but focussed on the implementation of the transfer. We assessed whether Transport Canada exercised due regard to economy in the sale process; established adequate

procedures to protect the interests of the Crown during the transfer process; disclosed the full costs of the commercialization; employed appropriate contracting practices in acquiring financial advisory services; and put in place adequate procedures to regulate the safety of the system and receive assurance of its safety.

19.24 The International Organization of Supreme Audit Institutions, through its subcommittee on privatization, has examined the international experience with privatization. Our review of the INTOSAI work and our discussions with others who have experience in divestiture lead us to conclude that in transfers of government services, the risks inherent in these transactions are reduced when the process is done in two phases. First, the operation to be divested is carved out of government operations and commercialized as a government-owned entity. There follows a period of operational stabilization in which the new entity puts in place the management and financial structures it needs to operate on a stand-alone basis. Only when the new organization is clearly defined and operational would a government elect to move the function to a private corporation. Exhibit 19.2 describes the most current and pertinent example, the vet-to-be-completed privatization of the National Air Traffic Service (NATS) in the United Kingdom.

19.25 In addition to privatizing some Crown corporations in recent years, the Government of Canada has also transferred a special operating agency, the Canada Communication Group, to the private sector. In that case, the government followed a two-phased approach. Such an approach was not formally considered by the government in setting out the commercialization options for the air navigation system.

Experience in divestiture shows that the risks inherent in these transactions are reduced when the process is done in two phases.

Such an approach was not formally considered by the government in setting out the commercialization options for the air navigation system.

Exhibit 19.1

Chronology of Events Leading to Air Navigation System Transfer

1991–93	Groups of Air Navigation System (ANS) users, employee unions, Transport Canada managers, a Ministerial Task Force on Aviation Matters, the Royal Commission on National Passenger Transportation and the aviation community in general voiced the opinion that the ANS was underfunded, hampered by government policy, and not meeting the needs of the aviation community. There was a need for change.
Late 1993	Transport Canada established a project team to study the feasibility of ANS commercialization, with five discussion papers being prepared.
Late 1993	Establishment of a Steering Committee consisting of representatives from Transport Canada, other departments and central agencies.
February–March 1994	Announcement by Government that Transport Canada would study options for the commercialization of the Canadian civil air navigation system.
April 1994 to Jan 1995	Establishment of the Commercialization Advisory Committee made up of representatives from government, user groups, industry, unions and the public.
Spring through fall, 1994	Extensive consultative process conducted across the country based on the five discussion papers to allow all interested parties to comment. Conducted with aviation community, interested parties, clients and employees.
February 1995	Consensus by Advisory Committee to support the not-for-profit option, and disbanding of Advisory Committee.
February 1995	Guiding principles and recommendations, developed in collaboration with the Steering and Advisory Committees and officials from other government departments, were submitted to Cabinet for approval.
February 1995	The Budget speech announced the approval of the recommendation of the Minister of Transport, supported by the Advisory Committee and the majority of ANS bargaining agents, that the ANS be commercialized by means of a sale to a not-for-profit corporation.
May 1, 1995	Appointment of Chief Negotiator and Deputy Chief Negotiator, establishment of project team.
May 26, 1995	NAV CANADA incorporated as a corporation without share capital under Part II of the <i>Canada Corporations Act</i> for the purpose of acquiring, developing, operating and maintaining the ANS.
July 1995	Negotiations began.
September 8, 1995	Transport Canada, NAV CANADA and the nine employee bargaining agents signed a tripartite Memorandum of Understanding on human resources expressing strong commitment to equivalency for employees.
December 8, 1995	An agreement-in-principle was signed with NAV CANADA to sell the ANS for \$1.5 billion net.
March 14, 1996	Introduction of the <i>Civil Air Navigation Services Commercialization Act</i> into the House of Commons by the Minister of Transport.
April 1, 1996	The formal contract, the Agreement to Transfer, was signed by Transport Canada and NAV CANADA.
June 20, 1996	The Civil Air Navigation Services Commercialization Act received royal assent.
October 31, 1996	The deal closed, with NAV CANADA assuming responsibility for operating the ANS on the official transfer date, November 1, 1996.

Source: Transport Canada

Observations and Recommendations

Valuation of the Air Navigation System

19.26 In any sale, due regard to economy requires that the seller enter the process with a clear understanding of the entity to be sold and its value. This information then becomes a benchmark for reference during the sale, against which the seller can assess the buyer's proposals. Once the sale is completed, the seller can be held to account for the variance (positive or negative) between the sale price and the valuation. We emphasize that "due regard to economy" does not mean that the purchase price must equal the valuation; rather, it means that the value must be known and any difference should be explained.

19.27 Accordingly, in assessing whether the Department exercised due regard to economy in carrying out the sale of the air navigation system to NAV CANADA, we focussed our audit work on what, in our view, was the key issue: valuation.

The entity to be transferred was not fully segregated

19.28 In any such transaction, a clear and comprehensive definition of what is to be sold is important because the usefulness and quality of the valuation depends on how fully the entity is defined.

within the next year.

19.29 Transport Canada conducted a conceptual exercise in 1994 to determine the financial position and financial results for the air navigation system were it to be commercialized. It compiled estimates of the system's expenses and revenues by making a large number of tentative assumptions. However, it did not obtain any independent assurance as to the reliability of the financial figures resulting from the conceptual exercise.

19.30 Transport Canada informed us that it defined several major elements of the sale with NAV CANADA during the negotiation process. Although it may be common to have some of the elements of sale defined at that stage, we found that the impact of many of these elements on the value assigned to the system was potentially quite significant. They included the identification of major revenue streams and of designated employees, the duration of the monopoly right, development of the regulatory framework, assignment of major capital projects, actuarial assumptions for employee severance pay and pension liabilities, and land assessment for ownership and environmental liabilities.

19.31 Transport Canada has made it clear that throughout the sale process the reliability of the inventory and asset management information system was questionable and that any figures provided were always covered by the statement that they were gross estimates. In the spring of 1996, the Department began to execute

The usefulness and quality of the valuation depends on how fully the entity is defined.

In 1972 the British government established the Civil Aviation Authority (CAA) as a nationalized industry — combining features of a special operating agency and a Crown corporation for regulation. Over a number of years, the National Air Traffic Service (NATS) — the operator of the air navigation system — was increasingly separated from the regulatory part of the CAA, culminating, in 1996, in its formation as a limited company wholly owned by the CAA. The effect of this was twofold: first, the regulatory regime was established and stabilized, making possible the development of a clear distinction between the operator and the regulator, each with well-defined roles and responsibilities. Second, the NATS organization was put on a sound financial footing and issued its first set of audited

financial statements this year. It is expected that NATS will be privatized through a stock flotation

The Privatization of the Air Navigation System in the United Kingdom

Exhibit 19.2

Separating the entity and having it operate on its own for a certain period helps to improve the understanding of exactly what is being sold.

Many of the underlying assumptions and forecasts used in determining the air navigation system's value were not documented.

procedures to improve the accuracy and reliability of the information.

Transport Canada's "lessons learned" study

19.32 The Department conducted a study to identify lessons learned from its own and the government's overall approach to the commercialization of the air navigation system, and to identify key strategic issues for similar undertakings in the future. The Department was to prepare an interim and a final report. On 31 March 1996, it produced an interim report on the lessons learned during the process of negotiating the transfer.

One of the lessons was the benefit 19.33 of clearly identifying and segregating assets prior to entering negotiations. The study also concluded that if an entity being sold resides within a larger organization, as was the case for the air navigation system, and if there is time, consideration should be given to separating the entity and having it operate on its own for a certain period of time as this helps to improve the understanding of exactly what is being sold. Although this interim report identified significant lessons that would have warranted a final report upon completion of the transfer, we were informed by the Department that there would be no final report. This is unfortunate because, in our view, the study was a positive step by the Department to identify key lessons from this transfer that could be used in preparing for other government divestitures.

19.34 These lessons were reinforced by the Department's principal financial advisor who wrote indicating that the transfer involved some potential risks, caused in part by the uniqueness of divesting directly out of a government department instead of through a separate government-owned entity. Further, the

financial advisor expressed concern that the air navigation system was not a self-contained commercial entity with segregated financial reporting and management information systems, and accordingly there were no audited financial statements upon which the potential purchaser could rely for its valuation and purchase decisions.

Transport Canada's valuation lacked key documentation

19.35 Before the transfer, Transport Canada valued the air navigation system using both going-concern value and net book value approaches.

19.36 We looked at the reliability of the financial information and the documentation for the range of values used by Transport Canada in arriving at the value of the air navigation system.

19.37 We found that many of the key numbers used to determine the going-concern and net book values were based on unaudited historical financial information, on which Transport Canada neither sought nor received external assurance.

19.38 The Department and its financial advisors did extensive analyses in preparing for the sale process and the results of some of this work are contained in documentation made available to us. However, critical gaps in the documentation made it impossible for us to fully review much of this information. For example, many of the underlying assumptions and forecasts used in determining the air navigation system's value were not documented. We requested working papers and analyses for revenue assumptions, operations and maintenance expenditures, capital expenses, financeability, the assumed growth rates and rate charges for the revenue assumptions, assumed efficiency rates,

number of employees, salaries and benefits, the forecast capital expenditure breakdowns, etc. The Department was unable to provide us with a sufficient set of working papers supporting the assumptions used in its key valuation models. Such supporting information would have provided, among other things, the details and rationale behind the numbers used in Transport Canada's key going-concern models. The Department has explained to us that because of the way the negotiations proceeded, later changes in the assumptions were not documented.

- 19.39 The Department was similarly unable to provide us with the rationale and support for the net book value it arrived at, the reasons for excluding capitalized interest and the evidence for other adjustments.
- 19.40 Due to the lack of supporting documentation, our Office is unable to comment on the reliability of the valuations arrived at by the Department.
- 19.41 In future divestitures, the government should properly document its key valuation models and maintain a complete set of working papers to support the assumptions used in determining value.

Transport Canada's going-concern valuations

- **19.42** A going-concern value is generally expressed as a range of values based on anticipated future financial results. This is normally quantified using a discounted net cash flow.
- 19.43 In the summer of 1994, Transport Canada entered into an agreement with its principal financial advisor for services that included assessing the potential value of the system. Although the financial advisor determined the potential value for different

entity types, in this section our discussion focusses on the valuations prepared for the selected form, the not-for-profit entity.

19.44 Initial going-concern valuation.

Before entering into the sale process, the Department and its financial advisor developed an initial going-concern valuation of the air navigation system of between \$1.0 billion and \$1.3 billion. However, this exploratory valuation did not adequately consider, among other things, the full impact of introducing overflight charges, a key revenue stream.

- 19.45 Subsequent work. During the months that followed, as Transport Canada proceeded to define more precisely the various components of what it was selling, the Department and its principal financial advisor significantly revised the estimates of the value of the air navigation system. Most notably, the planned introduction of the overflight charges in late 1995 increased the revenue potential of the entity by more than \$300 million a year. This could, over time, bring the gross revenue potential from about \$700 million to over \$1 billion per year.
- 19.46 In assessing an entity's going-concern value, it is important to have the value tested in the financial markets. In this case, because the corporation was intended to be financed entirely through debt, the test of that market was to help determine the amounts investors were willing to risk in the venture. This test of the market, known as assessing the financeability of the entity, provides an additional indication of whether the assessed value is reasonable.
- 19.47 On 1 August 1995, Transport Canada hired a second financial advisor to review the earlier financial models used to determine the value of the air navigation system and to assess the financeability of

Due to the lack of supporting documentation, our Office is unable to comment on the reliability of the valuations arrived at by the Department.

The estimated "going concern" value given

by the financial

advisors for a

was \$2.4 billion.

perpetual monopoly

The \$2.4 billion
estimate of value
became the figure that
was central to
subsequent advice
provided to the
Department.

the entity, particularly in the United States and international markets.

The financial advisors' joint 19.48 valuation: \$2.4 billion. In late September 1995, the Department's two main financial advisors made a joint presentation to senior officials of Transport Canada. They presented a number of possible valuations based on differing assumptions about the conditions of sale. The most critical of these was the issue of whether the monopoly on services would be granted for a limited time period or in perpetuity. Accordingly, estimates of value were prepared based on terms of 10, 20 and 30 years. The 30-year term effectively approximates in value a monopoly in perpetuity. These models showed clearly that a grant of monopoly for a more limited fixed term would result in a very sharp decline in estimated value. Ultimately, the Department decided to transfer the monopoly in perpetuity. The estimated value given by the financial advisors for the 30-year (perpetual) monopoly was \$2.4 billion. This estimate incorporated both going-concern and financeability considerations.

To the extent possible, we reviewed the model used to generate this estimate. We found that the assumptions used were conservative (that is, they tended to underestimate the value of the system). For example, the model was based on an assumption that the rates charged by the corporation, and its revenues, would begin to fall as early as the fourth year and would continue to decline thereafter. The model also assumed less-rapid recovery of full costs than is permitted in the legislation or planned by NAV CANADA based on its prospectus. The estimate also assumed that the corporation would be fully taxable; as a not-for-profit corporation, NAV CANADA is not currently taxable. Thus, the estimate of \$2.4 billion on a going-concern basis, in

light of the actual terms and conditions of the transfer and based on the documentation available to us, could materially understate the value of the civil air navigation system.

19.50 Although the financial advisors did not provide a valuation opinion on that estimate, or any other, based on the documentation available to us the \$2.4 billion estimate of value became the figure that was central to subsequent advice provided to the Department.

Net book value, an inappropriate measure

19.51 As early as 1994, Transport Canada had estimated that the net book value of the air navigation system by 1 April 1996 would be \$2.6 billion. The net book value of an entity is determined by accumulating all the costs, including financing costs incurred to acquire the assets (such as land, buildings, and systems) that are used in generating revenues, net of depreciation and liabilities.

The net book value is generally 19.52 not used to measure the value of an organization to be sold or transferred as a going concern. While the information is useful in preparing for a sale, it provides little or no information about the cash flow generation potential of the assets, which, in a going concern, forms the basis of their value. We reviewed the government's estimate because it was the benchmark against which the Department reconciled the "purchase price", and because of its relevance to the Department's objective of transferring the full cost of the system from taxpayers to the users of the system.

19.53 In October 1995, the Department of Finance informed Transport Canada that it believed that the government should be recovering its investment in the air navigation system by asking for a transfer

value equal to the book value. It noted that the financial advisors had stated that it was reasonable and defensible to use a net book value of \$2.6 billion, including capitalized interest, as the transfer value of air navigation system assets. In its support for this conclusion, Finance indicated that Transport Canada had used the net book value of \$2.6 billion in recent international discussions to justify the introduction of overflight charges. It concluded by saying that in its view the net book value of \$2.6 billion, including capitalized interest, should be the basis for further discussions.

19.54 In reply, Transport Canada suggested that in its view the net book value was \$1.9 billion. It arrived at this figure by removing from the higher figure the capitalized interest associated with the major Crown projects, such as RAMP (Radar Modernization Project), that had developed the technical infrastructure of the air navigation system. Because the commercialization legislation and applicable ICAO (International Civil Aviation Organization) guidelines enable NAV CANADA to recover all costs including capitalized interest through user fees, and because those interest costs were a real part of the cost of those projects to the Crown, the reduction should not have been made. Moreover, our review of the available documentation leads us to conclude that the adjusted net book value used by the Department is understated by at least \$140 million.

19.55 We asked Transport Canada for its rationale for using the net book value as the basis for determining the value of the commercialized air navigation system. The Department informed us that it had focussed on net book value based on advice that ICAO cost recovery guidelines had established this figure as a ceiling on recoverable costs. We have reviewed the

applicable ICAO guidelines and cannot find support in them for this conclusion.

19.56 The importance of using going concern as the basis for commercial valuation was further demonstrated by NAV CANADA in its 1996 prospectus, in which it made a preliminary allocation of only \$100 million of the purchase price to the air navigation system assets, valued by Transport Canada at \$2.6 billion. NAV CANADA also allocated only \$36 million of its purchase price to the liabilities it assumed. The remaining \$1.481 billion of the purchase price was allocated to the monopoly right or intangible entitled "air navigation rights".

The Department of Finance believed that the net book value of \$2.6 billion should be the basis for further discussions.

Amount of transfer

19.57 On 31 October 1996, Transport Canada received a payment of \$1.5 billion from NAV CANADA for the transfer, after extensive negotiations between the government and the purchaser.

19.58 Exhibit 19.3 shows how the Department compared the price it received with its "adjusted" net book value of \$1.9 billion. As we have noted, in our view neither the adjusted net book value nor the net book value of \$2.6 billion by themselves represent appropriate bases for valuation in the circumstances of this transaction.

19.59 The more appropriate basis for estimating value is to use a going-concern approach. As discussed earlier, the going-concern estimate of value that was based on assumptions most closely approximating the conditions of transfer was a conservative estimate of \$2.4 billion. Additionally, we were informed by Transport Canada that financeability alone suggested that the market would have been prepared to support much higher values.

19.60 The Department did not request or receive from its financial advisors any

Transport Canada suggested that the net book value was \$1.9 billion.

Transport Canada received a payment of \$1.5 billion from NAV CANADA for the transfer.

The Department did not request or receive from its financial advisors any formal statement of their valuation of the entity. formal statement of their valuation of the entity, despite the amount of money involved and the government's requirement for assurance.

19.61 As part of a professional and independent valuation opinion, the Department would also have received assurance on the reliability of the financial and other information used in preparing the valuation. However, the Department explicitly specified in the contract with its principal financial advisor that such assurance did not have to be provided. We believe that in a transaction this large and complex, carried out with only one potential purchaser — and where the negotiations were taking place between the Department and an entity represented by some of the same people who had previously advised the Department on how the transfer should be arranged — the Department ought to have sought independent assurance through a formal valuation opinion.

19.62 In making significant divestitures, the government should ensure that prior to entering negotiations, it receives a formal valuation opinion from a qualified independent professional on the value of what is being sold.

Incomplete communication to government on value

19.63 Before the sale process began, the government approved Transport Canada's proposal to commercialize the air navigation system and directed the Department to obtain fair market value, as determined by its financial advisors and approved by the Department of Finance.

19.64 In November 1995, Transport went to the government seeking approval for its agreement-in-principle with NAV CANADA, including approval for a transfer price of \$1.5 billion. Although going-concern valuations had been produced, Transport Canada reconciled for the government the value to be received

Exhibit 19.3

Transport Canada's
Reconciliation of the Purchase
Price by Reference to
Adjusted Net Book Value

Purchase price	\$ 1,500,000,000	
Costs assumed by NAV CANADA		
Employee Liabilities/Grievances	40,000,000	
ERI/EDI and Transition Liabilities ¹	150,000,000	
Obligations for Foreign Military and State Aircraft Charges ²	130,000,000	
Effective Gross Proceeds ³	\$ 1,820,000,000	
Net Book Value ("adjusted") ⁴	\$ 1,900,000,000	

¹ERI and EDI represent Early Retirement Incentive and Early Departure Incentive respectively. This represents the highest value in the range of the actuarial estimates of possible costs that NAV CANADA would incur if it used these tools to achieve staff reductions. The use of this estimate overstates the case.

Source: Transport Canada

²This figure has not been audited; no evidence to support it was received from the Department.

³This tabulation does not contain any of the costs to the Crown of the transaction.

⁴This figure is intended to represent the net book value of the assets of the air navigation system. The Department has adjusted it to remove the value of capitalized interest. However, capitalized interest is a legitimate part of the cost of acquiring these assets, and is a fully recoverable cost regardless of who is running the system. Its omission understates the net book value of the assets by approximately \$700 million. Additionally, our review of the available documentation leads us to conclude that the adjusted net book value is understated by at least a further \$140 million.

from the transfer (including the price) by comparing that amount to the adjusted net book value (see Exhibit 19.3). We received no evidence to suggest that, at that time, the financial advisors supported the adjusted net book value approach, or that they thought that this value in any way represented a proxy for fair market value. No information on the results of the going-concern valuations was formally presented to the government in seeking its approval of the price.

Potential subsidy to aviation industry

19.65 In the making the decision to transfer the air navigation system to a not-for-profit corporation, the government accepted two interrelated financial objectives. First, the government wanted to end dependency on the taxpayer and the objective was to have the users pay the full cost of operating the system. Second, the Department was directed to achieve a price

that represented fair market value. In light of these objectives, we believe the negotiation of a purchase price that was significantly lower than the most reasonable valuations (on either a going-concern or net book value basis) represents a substantial indirect subsidy to the aviation industry, which was not properly authorized and disclosed. If one uses either the Department's final going-concern valuation of \$2.4 billion or the net book value of \$2.6 billion as the best available estimates of fair market value, then the magnitude of the subsidy could range up to a billion dollars.

Lack of due regard to economy

19.66 The Department failed to exercise due regard to economy in determining the value of the air navigation system.

Exhibit 19.4 shows basic steps that we believe would contribute to due regard to economy in future government transfers.

Further, based on the documentation

The Department failed to exercise due regard to economy in determining the value of the air navigation system.

- 1. Prior to entering into the sale process, the vendor should clearly define the entity to be sold, through the identification and segregation of all assets and liabilities, personnel and financial results.
- 2. Prior to entering into the sale process, the vendor should know the approximate going-concern value of what is being sold.
- 3. The vendor should use a valuation method that is consistent with the nature of what it is selling.
- 4. The vendor should have an independent and qualified financial advisor for the determination of the value of what is being sold.
- 5. The vendor should set a minimum floor price prior to entering into the negotiations.
- 6. The vendor should obtain a formal valuation opinion from a qualified professional on what is being sold.
- 7. The valuation should be based on information that is materially correct and complete.
- 8. The valuation should be revisited if there is a long period of time between the performance of the valuation of what is being sold and the date of the agreement to transfer and the date of the physical transfer.
- 9. The vendor should provide complete and accurate information to Parliament with respect to what is being sold.

Note: The above steps will contribute to ensuring due regard to economy in the determination of the value of what is being sold. It should be noted, however, that a proper valuation can be carried out only after the vendor defines clearly what is being sold.

Exhibit 19.4

Recommended Process for Future Government Transfers

> Basic steps that would contribute to ensuring due regard to economy in determining value

available to us, we conclude that the Department did not disclose to decision makers information on the potential going-concern value of the air navigation system.

Department's comments: Transport Canada's comments on this section can be found at the end of this chapter beginning at page 19–28.

Significant Costs of Transferring the Air Navigation System

Accountability to Parliament

19.67 Currently, there is no requirement for the government to account to Parliament for the financial and substantive results of divestitures. The costs of transferring the air navigation system to the

Exhibit 19.5

Transfer Activities: Schedule of Costs

Additional Pension ² Capital Assets		million
Additional Severance	31.5	million million
Other costs of transfer:		
Sub-Total ¹	\$ 25.7	million
Safety team activities	0.2	million
Corporate transition activities	3.6	million
Negotiation activities	16.0	million
Implementation activities	\$ 5.9	million

Notes:

¹Transport Canada estimates the total at approximately \$25 million.

not-for-profit corporation were significant—we estimate them at between \$245 million and \$375 million—but were not consolidated and reported to Parliament separately. (Exhibit 19.5 presents a listing of some of the major costs to the government associated with the decision to transfer.)

19.68 Where major divestitures of government operations are involved, the government should prepare a report for Parliament that sets out the results of the divestiture. This document should include a description of the transaction, an assessment of how the transaction as concluded is expected to meet the government's objectives for entering into it, and a summary report on the costs and proceeds of the transaction.

Severance and pension costs

19.69 In the spring of 1996, the air navigation system employees' pension liabilities to be transferred with them to NAV CANADA were estimated to total up to \$1.4 billion. Later estimates reduced this amount to \$1.3 billion. Severance payments were estimated at up to \$112 million.

19.70 Severance costs. Air navigation system employees transferring to NAV CANADA were paid an additional amount in severance because their employment with the government had been terminated (the entitlement rate for employees whose service is terminated is higher than for those who leave of their own volition). These amounts represent an additional cost of transferring the air navigation system and are estimated by the government to total at least \$31.5 million of the estimated total of \$112 million.

19.71 Pension costs. Under the agreement to transfer, employees had the option of transferring their pension to NAV CANADA or leaving it under the Public

²The government estimates the cost of transferring pensions to NAV CANADA to be \$274.7 million. However, in the future this cost may be partially offset by approximately \$130 million due to the effects of favourable interest rates.

³These costs are unaudited and do not include the costs incurred by other organizations involved in the transaction such as Justice, Treasury Board Secretariat and Finance; or costs of setting up Transport Canada's regulatory organization; or environmental remediation costs. As a result, we have no assurance that the total does not contain a material error, or that it is complete.

Service Superannuation Account. The government negotiated an amount to transfer to NAV CANADA for pensions that was significantly higher than the actuarial liability for these employees had there been no transfer. The amount to be transferred for each individual is the greater of either the actuarial liability on a negotiated set of assumptions or the result of a contribution test of twice the individual's accumulated contributions. with interest. The negotiated actuarial basis results in a larger actuarial liability than the public accounts assumptions, and the contribution test further increases the transfer amounts. Based on the information for the employees who actually transferred, we and the government estimate that the total liability could be up to \$1.3 billion (assuming all of the employees elect to transfer, as approximately 90 percent will). Of that amount, we estimate that up to \$275 million represents a cost attributable to the transfer, based on the combined effects on the liability of the negotiated assumptions and the contribution test. While this outcome is not unusual in pension transfer arrangements, in our view this amount represents a cost that should have been disclosed to the government as a separate cost directly related to the transfer. The government now advises us that because of favourable market interest rates, this cost will be partially offset by an amount that it currently estimates at about \$130 million.

Other Key Elements of the Transfer

Controls over the transition period

19.72 Although Transport Canada was under some pressure to complete the transfer quickly, it introduced some key controls that are worth noting as significant lessons to apply in future transfers. For example, detailed closing plans were

prepared and communicated to ensure that key financial controls were implemented to protect the public purse after the transfer. The financial closing plan included a list of procedures such as the cancellation of credit cards and phone cards, and a series of procedures subsequent to the transfer to ensure that the Department would recover any expenditures it had incurred on NAV CANADA's behalf. Other procedures were put in place to ensure that assets identified in the agreement were transferred. Furthermore, the Department provided for these transition procedures to be managed by employees who had been identified to remain with the Department, to ensure that the government's interest was being taken into account.

Contingent liabilities

19.73 The government is in the process of completing its environmental assessment of the condition of the lands transferred to NAV CANADA. The potential environmental liabilities are estimated by Transport Canada at between \$5 million and \$20 million.

Contracts for Financial Services

19.74 In the course of our audit of the valuation of the air navigation system, certain concerns came to our attention about the contracting practices used by the Department in the acquisition of financial advisory services. These concerns represent matters that we believe ought to be brought to the attention of Parliament.

The initial contract for financial advisory services

19.75 Following the government's announcement of its intent to study the potential commercialization of the civil air navigation system, Transport Canada decided to contract for financial advisory services. The financial advisor was to challenge the assumptions for building the

Transport Canada introduced some key controls over the transition period that are worth noting as significant lessons to apply in future transfers.

financial model of the commercialized entity. It was also to focus detailed study on three options for commercialization: a not-for-profit company, a mixed enterprise and a Crown corporation.

19.76 The Department called for bids on this work and a contract for \$165,000 was awarded. The contract covered the period from July to September 1994. It was subsequently amended on two occasions to extend the work period to March 1995 and to increase the amount payable to \$560,000.

The principal contract for financial advisory services

19.77 Early in 1995, Transport Canada decided that, as the next step in the commercialization of the air navigation services, it would require a financial advisor to assist its negotiating team. The advisor was intended to provide comprehensive financial advice leading up to a transaction, and to perform additional responsibilities in regard to financing the sale.

19.78 Initially, a sole-source oral contract was offered to the winner of the earlier contract. This appointment was confirmed by the contractor in a letter to the Department dated 25 May 1995. The written contract governing the provision of financial advisory services was not signed until after 12 April 1996, almost a year later. Much of the delay in signing the contract can be attributed to a request by the contractor for a revision of the indemnification clause. Ultimately, the contract was signed without the inclusion of the clause.

19.79 On 1 June 1995, the Department prepared a proposal for "Ratification of Contract" and submitted it to Treasury Board. The proposal was ratified on 15 June 1995. Ratification is normally

required for contracts let without the required authority from the Treasury Board, as a result of either an administrative error or a pressing emergency.

19.80 In the proposal, the Department asked for retroactive approval of a non-competitive contract based on a transaction fee of 0.4 percent of the final price, not to exceed \$4.6 million, and payable in arrears from 1 May 1995. It put forward several points in support of its request.

19.81 The need for sole sourcing. The Department stated that in July 1994, a competitively tendered contract valued at \$560,000 had been awarded to the financial advisor for advice in connection with the commercialization of the air navigation system. In fact, the competitive contract had been awarded for \$165,000 and was later amended to \$560,000.

19.82 The Department pointed out that it was committed to having the terms of the transfer arranged by the fall of 1995, which meant that in its view there was not enough time to call for competitive bids and potentially allow a new firm to familiarize itself with all the complex issues involved. Hence, it concluded that the firm it proposed was the only one ready and able to act as the financial advisor during the time-sensitive negotiations expected with the new entity.

19.83 Transport Canada had known by February 1995 that a financial advisor would be required. We do not have any indication that a competitive process could not have been completed in the time available, or why it was necessary to enter into this contract without first having received the appropriate authorization.

19.84 According to section 6 of the Government Contract Regulations, there are only four exceptions that permit the

A sole-source oral contract was offered to the winner of the earlier contract.

contracting authority to set aside the requirements to solicit a bid. The information provided by the Department does not adequately explain its reasons for sole sourcing. We are concerned that the practice of sole sourcing based on a contractor having won an earlier, much smaller contract, which was let competitively, circumvents the competitive bidding requirements and is unfair to other firms.

19.85 The basis of payment. In support of its intent to reimburse the advisor using a transaction fee, the Department stated that according to advice received from the Department of Finance, a reasonable transaction fee rate would be between 0.4 percent and 0.7 percent of the negotiated price and that this rate is standard in the industry. Transport Canada has no record of advice received from the Department of Finance on this matter.

19.86 When initial discussions were being conducted with the financial advisor about the second contract, it was contemplated that in addition to providing service of an advisory nature, the advisor might be involved on behalf of the government in arranging (underwriting) debt financing for the new entity. A transaction fee would be usual for underwriting. However, by June 1995 when the request for ratification was sent to Treasury Board, the requirement for underwriting duties had been removed from the draft terms of engagement and no such requirement is to be found in the written contract that was signed. The duties specified in the statement of work, and ultimately set out in the contract, would not normally be paid for on the basis of a transaction fee.

19.87 Payment before written contract. By 22 September 1995, the contract had yet to be signed, due to disagreements about the appropriateness of

indemnification clauses as proposed. However, the Department made a decision to pay for services rendered on the basis of an oral contract, and over \$1.4 million was paid to the contractor before the contract was actually signed.

19.88 Amendment. On 20 March 1996. the Department submitted to Treasury Board a request for approval to amend the price ceiling in the still-unsigned contract, from \$4.6 million to \$6.9 million. It stated that this amendment was required to reflect the significant increase in value achieved by the government for the sale of NAV CANADA and for additional services required. The request does not specifically note a decision made nearly a year earlier that services to arrange financing on behalf of the government would not be required of the advisor under this contract, or that a contract had not yet been signed.

19.89 Lack of deliverables. We did not find well-defined deliverables in this contract. Although Transport Canada has advised us that it received the financial advice it needed when it was needed, it is unable to demonstrate whether value for money was received from this \$6.9 million contract because it did not keep track of the time its financial advisors spent on the project or request that the advisors provide this information, to which it was entitled.

19.90 Questions about independence of advice. In May 1996, the Department gave permission to its financial advisor to participate in financing activities for the purchaser. The advisor's contract with the Department did not expire until the fall of 1996, at which time a final payment was made. According to NAV CANADA's prospectus, the financial advisor participated in the underwriting syndicate for NAV CANADA and shared in the transaction fee charged to NAV CANADA, which is the usual form of reimbursement for such activities. According to the

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financial advisor, its involvement with NAV CANADA did not begin until after the transfer had taken place, and its role was limited to the distribution of the securities.

19.91 We did not audit the financial advisor and we offer no opinion on its actions. Where our work touched on that of the financial advisor, we were concerned only with the appropriateness of the government's actions.

19.92 It would be reasonable to expect the government to require that its advisor on price, due diligence and negotiation strategy remain independent from the purchaser all the way through the negotiations, until the commercial closing of the deal and the physical transfer of the air navigation system. Accordingly, the Department should not have released its financial advisor from its exclusive duty to it until the transfer had been fully completed.

19.93 More generally, in many divestitures of government operations it is likely that, as in this case, in practical terms the relationship between the vendor and purchaser will be at less than full arm's-length. Government operations are often sufficiently specific that both management and labour will be a part of the divestiture. In these circumstances, in our view, it is vital that the independence of the financial advisor be fully maintained to ensure that the interests of the Crown are protected.

19.94 In future transfers, to protect the interests of the Crown, the government should ensure that the independence of the financial advisor is appropriately maintained in light of the nature of the transaction and the scope of the advisor's role in it.

The contract for a second financial advisor

19.95 On 19 June 1995 the Department sent out requests for proposals, seeking an American investment banking firm to act as an advisor to it on sale matters such as those related to the United States and international capital markets.

19.96 There were three compliant bidders. Their proposals were evaluated and the contract was awarded. The time taken to process this competitive contract, from the date of issue of the request for proposals to the selection of an advisor, was only 42 days.

19.97 The initial contract with the American advisor was for US \$375,000 and covered the period 1 August 1995 to 31 October 1995. There were a number of amendments to the contract, increasing the value from US \$375,000 to US \$1,050,000 and extending the time for completion to 1 April 1996. This financial advisor was contractually prohibited from participating in the financing activities of NAV CANADA.

19.98 As was the case with the other contract for financial advice, the deliverables were unclear and the Department's records provide no clear link, other than elapsed time, between the work actually done and the amounts paid. Further, the Department has not provided any evidence of the services paid for under this contract for the period of January through March 1996.

Department's comments: Transport Canada's comments on this section can be found at the end of this chapter beginning at page 19–28.

The Regulation of Safety

19.99 The transfer of the air navigation system to a private corporation meant that the Department was no longer responsible

for delivering these services. However, in the process it has become responsible for ensuring that NAV CANADA, the new deliverer, does so safely and in compliance with the Aeronautics Act and the Canadian Aviation Regulations, and in accordance with Canada's international obligations. When it becomes aware of a safety deficiency, the Department must attend to it expeditiously. To achieve these goals, the Minister announced, "Transport Canada has established safety regulations and standards that will apply to the new corporation and will monitor its operations to ensure compliance — just as the department now does in the case of commercial air carriers — thus ensuring the continued high level of safety Canadians have come to expect."

19.100 Meeting this commitment represented a formidable challenge for the Department. It was faced with developing and instituting a regulatory regime where previously there had been internal management oversight. This had to be done in a period of about 18 months, without skirting any of the requirements for consultation and notice. This did not mean, however, that the Department was starting from zero. Like all parts of the aviation industry, the delivery of air navigation services is highly structured and disciplined; it is bound by a web of internal procedures and international standards that specify both what is to be done and (often in considerable detail) how to do it. These instruments, particularly the very comprehensive body of International Civil Aviation Organization (ICAO) standards to which Canada subscribes, formed a solid foundation on which to build a regulatory regime.

Transport Canada uses performance-based regulation

19.101 In regulating NAV CANADA, the Department decided to adopt a performance-based approach. In this type of regime, the regulator defines very clearly the results to be achieved (or avoided), and permits the regulated party to decide how it will deliver those results while providing the regulator with the comprehensive data it needs for timely assessment of performance.

19.102 Advantages and risks. This approach has the advantage of being less intrusive and less costly to administer than a prescriptive system. It is assumed that in providing performance data and in assessing its own performance, the regulated party will bear most of the cost of regulation, and the regulator will be able to gain assurance of performance through review of the performance reports and a highly selective program of audits and inspections. However, such an approach is not without its risks. The Department's Safety Review Team noted that setting up the necessary information and performance measurement systems has been an obstacle to success in other attempts at this approach. The team particularly noted the difficulties in doing this in the reform of the rail safety regime, identified by the Railway Safety Act Review Committee in its report.

19.103 The Department has stated that the decision to adopt a performance-based approach to regulation was based on its overall approach to regulation and regulatory reform, which emphasizes the use of performance-based regulations where possible. The decision was made without benefit of an adequate analysis of

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the appropriateness, including the risks and benefits, of using performance-based regulation for the delivery of air navigation services by a private corporation. Developing a revised regulatory regime, starting from a well-established set of regulations and regulatory procedures in a relatively stable set of relationships, is a task very different from setting up a new regime for a new organization with new senior management. However, the risk was mitigated by the fact that the new regulations were fully reviewed by the Canadian Aviation Regulatory Advisory Council, a group made up of representatives from all areas of the aviation industry.

19.104 The new regulatory program for the civil air navigation system was not developed on the basis of a comprehensive analysis of the risks inherent in it.

Although work was done to identify the relative seriousness of the principal hazards in the system, no documented risk analysis was conducted.

19.105 Because it assessed as low the safety risks inherent in NAV CANADA's early operation of the system, the Department's strategy was to start with the minimum number of components for a performance-based program. This decision was based on three assumptions:

- that the air navigation system, as provided by the Department at the time of transfer, had achieved an acceptable level of safety;
- that the operational environment would remain relatively stable after the transfer; and
 - that the transfer would be "seamless."

19.106 Our work looked at two issues. First, effective performance-based regulation requires a number of components, which have been identified in

the literature and in internal departmental reports. We assessed the extent to which those components are in place. Second, any regulatory regime requires that the regulator undertake a number of tasks in order to have assurance about the level of regulatory compliance. We looked at the Department's activity in this area; that is, at the procedures it had in place to obtain assurance that air navigation services were being delivered safely.

The System Safety Review

19.107 One of the key activities carried out by the Department in preparing for its role of safety regulator was the System Safety Review. This was an ongoing process that began in June 1995 and ended with the final report in July 1996; four interim reports were issued. The purpose of the review was to provide the Department with an ongoing assessment of the risks associated with the transition of the air navigation system from a government operation to a private enterprise.

19.108 The System Safety Review report identified several basic requirements for a performance-based regulatory regime:

- identification of regulatory goals;
- general reliance on standards of quality and performance measurement;
- determination of the most effective means of mitigating and monitoring air navigation system-related risks; and
- development of extensive feedback mechanisms to sample, analyze, and evaluate the effectiveness of the risk mitigation.

19.109 These requirements are very close to those we identified in setting our criteria for this part of our audit. We expected that in setting up such a regime the Department would develop:

- clear and comprehensive performance objectives or goals for each of the areas subject to regulation;
- a formal risk analysis leading to the identification of the key performance goals for which data are to be gathered to monitor performance;
- the specifications of the measurement procedures and data to be used to monitor performance;
- procedures to ensure timely and unimpeded access to all necessary data;
 - assessment of the data quality; and
- procedures to carry out independent verification of the data.

19.110 We discuss each of these below.

Performance goals for air traffic control

19.111 We found that the Department had established in the regulations the key performance criteria for air traffic control services, in the form of the Canadian Domestic Air Traffic Control Separation Standards. The critical performance goal for this area is the avoidance, through appropriate air traffic control, of losses of separation (distance) between aircraft. In other areas, such as the provision of navigation aids, the relevant ICAO standards have been incorporated into the regulations by reference; however, the ICAO standards are extensive, detailed and largely prescriptive. One area, automated systems, does not appear to be subject to any regulation, nor are there any current ICAO standards that apply, although Canadian air traffic control depends on such systems to a significant degree. In the interim, the Department is working on these issues with NAV CANADA to develop appropriate standards for automated systems performance. Once ICAO has developed standards in this area, they will apply to NAV CANADA.

Need for risk analysis

19.112 In a performance-based system that regulates an area as large and complex as the air navigation system, it is not practical to monitor everything. Risk analysis assists management in identifying the areas that need the most attention, and encourages the most cost-effective allocation of resources.

19.113 The need for risk analysis was identified relatively early in the System Safety Review process. The System Safety Review Team identified and catalogued the risks in the existing air navigation system and those inherent in the new regulatory regime, but it realized that its work was not a substitute for the type of systematic and quantitative analysis that was and is required. Since the transfer, the Department has settled on the methodology it will use for risk analysis and has identified the need for staff training. However, it will be some time in the future before the necessary analysis using the new methodology can be undertaken.

Reporting on performance of the air navigation system

19.114 Once the performance goals to be measured and the indicators to be used to measure them have been defined, the sources of the data used to create the indicators must be identified. For the air navigation system, the principal source of data is an incident-reporting system operated by Transport Canada, called CADORS (Civil Aviation Daily Occurrence Reporting System). Until the transfer, CADORS was an internal departmental management system designed to provide for quick reporting of a wide variety of aviation occurrences so management could identify problems and act quickly when necessary.

19.115 The new regulations have imposed on NAV CANADA the

The Department had established in the regulations the key performance criteria for air traffic control services.

requirement to produce reports that conform with the requirements of the CADORS Manual. The CADORS has the capability to provide relatively complete information on losses of separation — the avoidance of which is the principle objective of air traffic control services. However, while it can and does provide information on other aspects of the air navigation system, such as reporting on identified beacon failures, other sources of information on many NAV CANADA services will have to be identified.

19.116 The requirement that NAV CANADA report in accordance with the CADORS manual should, subject to NAV CANADA's compliance, provide for the timely reporting of key data.

Transport Canada
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receives from NAV
CANADA are
complete.

19.117 One of the problems identified in the System Safety Review was whether all incidents that were reportable under CADORS would be reported. This had been a problem and was anticipated to continue after the transfer. Transport Canada needs to work out a means whereby it can gain assurance that the CADORS reports it receives from NAV CANADA are complete. Since the transfer, there have been some problems in this area and the Department has informed us that it has taken steps to gain greater assurance. It compares the reports it receives from NAV CANADA with data from the mandatory incident-reporting system operated by the Transportation Safety Board. We have requested documentation of this process, but the process appears to be relatively informal and no documentation has been provided. While the threshold of seriousness in the Safety Board's system is higher than in CADORS, a proper reconciliation would provide some assurance on the consistency of reporting between the two systems, and at a relatively low cost.

19.118 The Department has indicated to us that it is concerned about the problems of having a number of different systems measuring various aspects of aviation safety, using different definitions and sensitivities. It is considering developing a single system to capture the necessary performance information on a consistent basis. In view of the Department's commitment to increase the use of performance-based regulation, the development of reliable and economical sources of data is important.

Independent verification of performance data

19.119 One of the obligations of the regulator, particularly in a performance-based regulatory regime, is to perform independent tests from time to time to derive the necessary assurance that the information on which it is relying is accurate and complete. In the case of the air navigation system, such verification is made possible by the requirement that recordings of both voice and operational information be made and retained by NAV CANADA. Considerable operational data can also be obtained from flight records and tapes.

19.120 In a new regulatory environment, one would normally expect the level of audit activity to be quite high, declining over time as problems were resolved and assurance of reliability achieved. However, by the end of our audit fieldwork the Department had neither planned nor conducted any audits to verify the quality of the data supplied by NAV CANADA.

Audit and inspections of safety

19.121 One of the key elements in the safety regulatory regime is the requirement that NAV CANADA have a safety management program by which it monitors, inspects and reviews its own operations. Transport Canada believes that

once this program is fully operational, it will be able to derive much of the assurance it needs about NAV CANADA's compliance with the necessary procedures by receiving and reviewing the products of that safety program. It should be noted that while NAV CANADA is required by the regulations to develop such a program, the program will not be required to meet with Transport Canada's approval. Nor, it appears, would the absence of that approval bar NAV CANADA from operating the air navigation system.

19.122 Once NAV CANADA's safety program has been completed and put fully into operation, the Department will still need to supplement its receipt and review of NAV CANADA's reports with direct audits and inspections of its own. As noted in our discussion of data verification, we would expect the level of audit to be relatively high until a clear pattern of reliance has been established. In particular, we would expect the effort to be particularly intensive during the period when management's controls and procedures are still being designed and put in place. By the completion of our audit work, however, because it assessed the risks as low, the Department had only limited audit plans to conduct Site Manual validations and had not yet done any safety audits of NAV CANADA.

Safe delivery of air navigation services

19.123 When the government agreed to the transfer of the air navigation system, one of the conditions it established was that the necessary safety regulations and the Transport Canada resources to apply and enforce those regulations be in place prior to the transfer. The Department had the current regulations in place prior to the transfer date, and it had staffed some, but not all, of the positions in the new directorate that is responsible for regulating

NAV CANADA. In particular, the Department has stated that all key personnel were in place with adequate resources. However, as we have noted, Transport Canada has some distance to go before it has in place a fully functioning regulatory regime for NAV CANADA. The legal and regulatory foundations have been established and the Department has very recently approved its Policy Framework for the Safety Oversight of Canada's Air Navigation System. Nonetheless, there are important matters of risk, data, and audit and inspection that must be resolved before the regime can be said to be fully operating. Based on the System Safety Review and a consultant's follow-up report for the Department after the transfer, the Department is fully aware of the issues that need to be resolved and is in the process of drafting action plans and taking steps to deal with them. According to the Department's plans, it will take well into the next year to resolve some of the outstanding issues related to risk analysis and performance measurement.

19.124 In discussions with departmental officials we have been informed that there is nothing untoward in this state of affairs; in their view, the risks inherent in the situation are very low. Indeed, the Department has written to us to state that in its view, as at the date of transfer and since then, the necessary safety regulations and Transport Canada resources for the application and enforcement of those regulations have been in place and functioning in all material respects. While the Department has not fully implemented its safety oversight program, and does not have assurance of NAV CANADA's compliance with the safety requirements of the Canadian Aviation Regulations, it points to a number of factors that give it some comfort that it would be aware of any problems that existed. These factors include the view that prior to transfer the

Transport Canada has some distance to go before it has in place a fully functioning regulatory regime for NAV CANADA. There are important matters of risk, data, and audit and inspection that must be resolved.

More than half a year after the transfer, no audits or inspections of NAV CANADA's operations had been conducted by Transport Canada.

system was safe and that it will continue to be operated by NAV CANADA in the same way, including the continuation of all of the system safety oversight activities formerly carried out by Transport Canada; its strong belief that NAV CANADA's management has no incentive to operate in other than a safe manner; the data and information that it currently receives from NAV CANADA, including personal contacts with key NAV CANADA personnel; and, at senior levels in the Department, ongoing contacts with NAV CANADA's clients.

19.125 Comfort, however, is not assurance. Assurance is the result of a planned process of analysis and investigation. Until Transport Canada has made significant further progress in implementing the key elements of its performance-based regulatory regime, it will not be in a position to have full assurance concerning NAV CANADA's operational compliance with the requirements of the Canadian Aviation Regulations and ICAO standards. At the end of our audit, more than half a year had passed since the transfer and no audits or inspections of NAV CANADA's operations had been conducted by Transport Canada.

Transport Canada's comments:

Regulation of Safety

Transport Canada is confident that the new air navigation system provider, NAV CANADA, is committed to highly safe operations and indeed the Canadian Aviation System remains among the safest in the world. This commitment to a high standard of safety is ensured by:

- 1. the government's regulatory powers under the Aeronautics Act;
- 2. the authority of the Minister under the Canadian Aviation Regulations to issue an order to NAV CANADA to maintain or increase the level of service in the interests of safety; and

3. the requirement to notify Transport Canada of any occurrences, coupled with the Department's powers to inspect and audit.

The government has authority under the Aeronautics Act over all aspects of aviation including the safety oversight of air navigation system service providers. Part VIII of the Canadian Aviation Regulations (CARs) applies specifically to the air navigation system. The regulations provide for standards to be achieved by NAV CANADA, and the Aeronautics Act provides the authority for audit and inspection of services and facilities. Licensing and training standards for air traffic control are also specified in Part IV of CARs. NAV CANADA must also notify the Minister of the termination or reduction in the level of service and the Minister has the authority to request that the service be maintained or increased in the interest of safety. The Department is vigilant in overseeing operations to ensure that Canada's exemplary aviation safety record is maintained in the new, innovative operating environment.

The Auditor General recognizes that prior to the transfer of the air navigation system to NAV CANADA, Transport Canada had established the legal and regulatory foundation for the regulation of NAV CANADA. Transport Canada had also established a multi-disciplinary team to assess the scope of the safety oversight program, developed a new branch with inspection and audit authority, and completed a comprehensive System Safety study.

Further work has been completed since the transfer, such as the completion of a Regulatory Framework, which includes the program for inspecting and auditing facilities and investigating safety issues and incidents.

It had been more than 50 years from the inception of the air navigation system until its sale to NAV CANADA, at which time the personnel and operating infrastructure were transferred in total. As a result, at the

time of the transfer, it was the Department's assessment that the air navigation system had achieved an acceptable level of safety and that the new corporation would assume management of the air navigation system in a responsible, professional and safe manner, given that there was essentially no change in operational staff and that an effective safety program had been established by NAV CANADA.

The studies referred to in the Auditor General's Report were initiated by the Department as a self-assessment of the air navigation system's regulatory safety program and the status of implementation. Both an internal study and a consultant study have been used to reconfirm and refine elements of the program. The self-assessment studies initiated by the Department reflect the philosophy of continuous improvement needed in a highly technical and complex national air transportation system.

Value and Process

The Department is of the view that the price agreed upon for the air navigation system represented the best deal available in the circumstances at the time of the transfer.

Both the purchase price and the choice of a one-phase transfer were appropriate and completely justifiable, given:

- the policy decision to pursue exclusively the not-for-profit corporation model with user group involvement;
- the economic climate and risks assumed by the purchaser;
- the need to move quickly to capitalize on industry and employee consensus; and
- the pressing need for a new management model to meet current technological challenges.

One of the government's key objectives was to transfer the air navigation system to a not-for-profit corporation with a suitable balance of stakeholder interests and an acceptable framework for accountability, governance and safety. Considerable time and effort were invested during 1994–95 in working with an Advisory Committee made up of a wide diversity of stakeholders to arrive at such a balance of interests.

Clearly, it was an immense step to move from a departmental program into a private sector corporation. However, a two-phase approach would have delayed implementation of organizational improvements and led to continuing technological and operational delays for air navigation system users. It was also important to seize the window of opportunity presented by the consensus that had been reached in the aviation community and with ANS employees and their bargaining agents as to the direction to be taken.

An extensive study phase preceded the decision to transfer the system, during which various criteria and assumptions were developed and a number of financial models and other equally important aspects of the proposed transfer were examined. Following this study phase, a set of principles to guide the negotiations was approved by Cabinet.

The monetary value was important for the government. However it was not the sole objective. If it had been, the transfer would not have taken place the way it did. This context is ignored in the Auditor General's review of the transaction. It might have been easier to address the value question and other matters through a two-phase process. However, given the opportunity to capitalize on the acceptance of alternative service delivery concepts, the "user pay-user say" willingness exhibited by the aviation industry and the need to move quickly, the government decided to commercialize the air navigation system directly from a departmental program.

There is also an historical context to the negotiations that is ignored in the Auditor General's report. This opportunity was being pursued in a period of considerable

Transport Canada – The Commercialization of the Air Navigation System

economic uncertainty and risks that had to be managed, such as:

- interest rates;
- the deficit;
- credit ratings;
- future trends in aviation traffic;
- the potential for revenue fluctuations;
- uncertain operating and technology system modernization costs;
- the challenges of introducing efficiencies to the system while at the same time retaining good relations with a unionized workforce.

All of these factors affected the nature of the transfer of the air navigation system to an entity that had to exhibit long-term viability to lenders. There were legitimate concerns about the ability of a new entity to raise very large amounts of funds at an acceptable cost. It was concluded that these factors contributed to a value that could be represented not only by cash but also by the acceptance by NAV CANADA of these obligations and risks.

The opportunity was seized and the price was negotiated within this context.

With respect to the determination of monetary value, depending on the model and assumptions used, a wide range of values for the air navigation system was generated, varying from approximately \$1.1 billion to \$2.6 billion depending on the assumptions. Given the decision to use the not-for-profit model, and that negotiations took place between a willing and knowledgeable purchaser and seller, it is the Department's opinion that the \$1.5 billion cash proceeds represented the best deal available given all of the circumstances at that time.

It should be recognized that the purchase price or value ultimately has to be recovered from users of the air navigation system. The not-for-profit entity ensures that users are not burdened with the profit-

maximizing objective of a for-profit entity that would pass on this additional cost to users.

Transport Canada had to address many of the information requirements to complete this transaction on an ongoing basis. Information to the Treasury Board and other decision makers was disclosed as the data became available for reconciliation and consolidation.

It is true that the Department was unable to identify all of the ultimate points around the transaction until certain building blocks and timing issues were completed. This situation made accurate determination of certain costs impossible until much later, but at no time were decision makers misinformed as to the magnitude and implications of the contemplated transaction.

Contracting Practices

Transport Canada had a short period of time to achieve the commercialization of the air navigation system. Following the Budget of February 27, 1995, the Minister of Finance announced the government's intention to proceed with the commercialization of the air navigation system. The Department was to achieve this result as early as possible in fiscal year 1996–97.

Given the relatively short timeframe to achieve this result, the Department elected to build upon the expertise and familiarity of a financial advisor who had previously assisted in developing appropriate models for the commercialization of the air navigation system. The advisor would be retained to provide a variety of financial services to the Department to implement the "not-for-profit" model. The time required to potentially bring another financial advisor "up to speed" through a competitive contracting process would have severely impeded the Department's ability to meet the expected timeframe for implementing the commercialization of the air navigation system. This exact rationale was provided by the Department in its

submission to the Treasury Board to ratify a non-competitive contract with a financial advisor.

The execution of a written contract between the Department and the financial advisor did take several months to complete, as the Department and the financial advisor could not come to a successful resolution on a common understanding of the term "indemnification" in the context of this particular contract. However, all other conditions of the proposed written contract were agreed to by the parties at the very early stages of the contract engagement.

Paragraph 19.86 of the Auditor General's Report makes reference to underwriting duties of the financial advisor being "removed from the draft terms of engagement and no such requirement is found in the written contract that was signed." The Department erred by this omission, as it had been an integral part of the negotiation and contingency planning process with the financial advisor and was included in the agreement with the financial advisor.

Treasury Board Secretariat's comments:

Severance and Pension

On severance, the government's decision was that it would honour its contractual obligations and respect the collective agreements with its unions, i.e. to pay severance at the lay-off rate. This decision was taken with full knowledge of the associated higher costs.

On pensions, the overall potential liability transferable for pensions, estimated at up to \$1.4 billion, was fully disclosed to the decision makers, as well as the proposed terms of the agreement. The negotiated actuarial assumptions recognized that NAV CANADA would be investing the transferred funds at prevailing market rates while the government returns were based on investments made over the past 20 years.

In our view, the additional costs in the chapter are overstated and the final amount is expected to be some \$100 million to \$120 million in excess of the actuarial liability. This amount will reduce the growth in the actuarial surplus in the Public Service Superannuation Account but does not increase the government's expenditures related to pensions.

Contracting

It is the view of the Secretariat that the contract submissions from Transport Canada, as approved by the Treasury Board, were supportable and met the requirements of the Government Contracts Regulations and, apart from the retroactivity involved, conformed to the Treasury Board Policy on Contracting.



Chapter 20

Public Works and Government Services Canada

Privatization of the Canada Communication Group The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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Assistant Auditor General: Shahid Minto Responsible Auditor: Alain Boucher

Public Works and Government Services Canada

Privatization of the Canada Communication Group

Main Points

- **20.1** The government made the decision to privatize the Canada Communication Group (CCG) and approved the sale process in April 1996.
- 20.2 The government's privatization objectives were to obtain best value for the sale of CCG, with minimum risk and liability for the government, and to minimize the impact on the printing industry while securing job continuity in the private sector for as many of its employees as possible. The government did not offer any guarantee of future business. However, to sell under the best conditions possible, it offered to prospective purchasers a business advantage, for a period of five years, in the form of privileged access to all government departments and agencies.
- 20.3 CCG was sold through a competitive sale process. The invitation to submit bids was made through the Open Bidding System. We found that the process was indeed open and attracted a significant number of bidders from the printing industry. The evaluation of offers received was conducted in accordance with the stated process and resulted in a proper evaluation of the bids. We therefore concluded that the offer submitted by the successful bidder, St. Joseph Corporation, represented the best value that could be obtained at that time under the conditions of sale specified by the government.
- **20.4** We found that there was satisfactory control over the transfer of assets and liabilities to the purchaser and that adequate revenue and expense cut-off procedures were used at the closing of the transaction.
- 20.5 CCG estimated the net cost for the divestiture of the organization at \$45.3 million. However, certain costs to be absorbed by other federal government entities as a result of the privatization were not included in this amount. Those costs included the waiving of about \$20 million to \$25 million of pension penalty costs for those who benefited from early retirement, and costs related to pension protection. The inclusion of the pension penalty costs alone would have brought the net cost of privatization to between \$65 million and \$70 million. In addition, the pension penalty costs were not included in CCG's analyses of the various future options for the organization. The inclusion of this cost element could have had an impact on the results of the cost/benefit analyses conducted.
- **20.6** We tested a sample of cases related to the Work Force Adjustment program established for CCG and found that they all complied with the conditions of the program. As well, we determined that the CCG program was comparable with the programs of departments and agencies subject to the Treasury Board Work Force Adjustment Directive.
- 20.7 We consider that the privatization process was well managed within the parameters set by the government; however, it is too early to predict whether this privatization will be a success in the longer term. Fairness to prospective purchasers and employees and jobs for employees were important criteria for the government, but resulted in costs (such as Work Force Adjustment costs) exceeding those that would have been incurred in a private sector transaction.



Introduction

20.8 In its February 1995 Budget, the government announced its intention to examine the prospects for the divestiture of the Canada Communication Group (CCG). The following July, the Minister of Public Works and Government Services Canada (PWGSC) established a specialist committee, comprising public and private sector experts in privatization, finance and human resources, to make recommendations on which components of CCG should be privatized, the public policy implications, employee considerations and the process to be followed. CCG hired a financial advisor to establish a value for the CCG business lines and to identify strategies for its sale that recognized the costs of public policy issues.

20.9 The recommendations of the specialist committee and of the financial advisor formed the basis of the privatization plan that was approved by the government. In May 1996, the Treasury Board gave its approval and the Minister of PWGSC announced the decision to privatize the printing and warehousing/distribution operations of CCG. The objective, as stated by the Minister, was to get the government out of a business that could best be operated in the private sector.

20.10 A competitive sale process began in June 1996 and, on 12 December 1996, the Treasury Board approved the sale of CCG to the Canadian-owned St. Joseph Corporation of Toronto. The Agreement of Purchase and Sale was signed the following day and the actual transfer to the new owner took place on 7 March 1997.

Evolution of the Canada Communication Group

20.11 The Canada Communication Group changed from a directorate within the Supply Operations Sector of the then Department of Supply and Services to a special operating agency (SOA) in June 1990. It was one of the first five special operating agencies created by the government. It operated under a revolving fund with the statutory authority to use its revenues to cover its expenditures. Its financial statements were similar to those of a private sector enterprise. Exhibit 20.1 provides some key dates in the history of the government printing function.

Products and services

20.12 CCG provided printing, distribution and warehousing, publishing and information management services to government departments and agencies on a fee-for-service basis. Some additional services were funded by annual appropriation, including a public reference service. CCG was also responsible for certain mandatory services such as the publication of the Canada Gazette and the Statutes of Canada, and the administration of Crown Copyright.

The Decision to Privatize

20.13 Until 1992, CCG's services were mandatory, which meant that federal departments were obliged to use CCG for their printing and communication needs. In 1992, the government changed this policy in response to recommendations made by the Public Service 2000 Task Force and made optional as many common services as possible. Henceforth, most services offered by CCG were provided on an optional basis, which meant that individual department managers had the right to choose their suppliers of printing services or to do the

Since 1992, most services offered by the Canada Communication Group (CCG) were provided on an optional basis.

work themselves. Only the publication of the Canada Gazette and the administration of Crown Copyright remained mandatory services of CCG.

20.14 This shift in the Treasury Board's common services policy had a major impact on all common services units using revolving funds. CCG was expected to operate in a revenue-dependent mode in a competitive environment. It had to demonstrate to customer departments that it could provide the best-value services.

20.15 CCG faced challenges from competitors in the private sector claiming that it had an unfair competitive advantage because of its dual role as a broker and a provider of printing and communication services. Although an

external review conducted at the time found that no conflict of interest had actually arisen, the printing procurement services (broker) function was nevertheless transferred back to the parent department to remove any appearance of conflict of interest.

20.16 The loss of its mandatory status and the transfer of the broker function to PWGSC (which accounted for about \$150 million in sales alone) caused CCG's sales to decrease from about \$400 million annually in 1993 to about \$100 million in 1996. Exhibit 20.2 provides key financial results from 1993 to 1997.

20.17 In the summer of 1994, the Minister of PWGSC announced the establishment of an advisory committee

Exhibit 20.1

Government Printer's Function – Key Dates

1869	The government appoints the Queen's Printer to supervise the printing of the Dominion's laws and its official newspaper, the Canada Gazette.
1886	The Queen's Printer also becomes the controller of stationary and assumed responsibilities for the printing requirements for Parliament. For the first time, all work was being done in a printing plant directly owned and operated by the government.
1969	The mandate is expanded to serve all of the federal government, not just Parliament and the Departments of Justice and Finance.
1970s	Many small printing facilities are combined with the Queen's Printer into the Communication Services Directorate of the then Department of Supplies and Services.
1990	The Communication Services Directorate becomes a special operating agency and is named the Canada Communication Group (CCG). Its printing services are mandatory for federal departments and agencies.
1992	CCG's services become optional to federal departments and agencies. CCG acquires the use of its own revolving fund, and starts to produce its own financial statements.
1993	CCG becomes a separate employer with complete accountability for its employees.
April 1994	Public Relations and Print Contracting Services function is transferred to PWGSC.
February 1995	The Budget reveals the government's intention to examine the divestiture of CCG.
May 1996	The plan to privatize CCG except some core functions such as the editing of the Canada Gazette is announced.
December 1996	An Agreement of Purchase and Sale is signed with St. Joseph Corporation.
March 1997	The Canada Communication Group is officially privatized.

composed of individuals from the public and private sectors to provide advice on the further direction of CCG. The committee tabled its report in December 1994 in which it recommended privatization of all functions of CCG that could best be done in the private sector, and the creation of the specialist committee to plan the privatization initiative. Subsequently, the Government Program Review Task Force made a similar recommendation.

CCG examined various options 20.18 and carried out cost/benefit analyses on each of them before the final decision to privatize was made by the government. The four main options analyzed were closing the organization, maintaining the status quo, downsizing CCG (competitive model) and privatizing with incentives. As a result of negotiations and decisions between February 1995 and December 1996, a Work Force Adjustment benefit program comparable with those for the rest of the public service was implemented for CCG. Analyses of all options included estimated Work Force Adjustment costs.

Functions privatized and those retained by the government

20.19 The functions that could best be done by the private sector were privatized. Some others were considered core functions of the government or not yet ready for privatization and were transferred back to the parent department or to other departments.

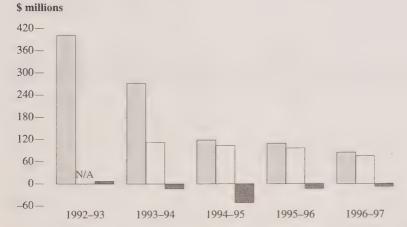
20.20 The remaining corporate services employees in the areas of human resources, finance, engineering and information technology who were not offered a job with St. Joseph Corporation or with the government will be declared surplus when their positions are no longer required.

20.21 Exhibit 20.3 gives the list of the business units that were privatized and those that were retained by the government.

Government privatization objectives

20.22 In an address to the Canadian Printing Industries Association in May 1996, the Minister stated that the aims of the government were to obtain the best

The aims of the government were to obtain best value while securing job continuity for as many employees as possible.



In 1994–95 the Public Relations and Print Contracting Services function was transferred back to the parent department. Corresponding sales for 1993–94 were \$156 million. This business generated profit of \$4.2 million.

N/A The 1992–93 gross revenue from business units privatized is not available.

Key Financial Results
1993–1997

Total revenue of CCG

Portion of total revenue relating
to business units privatized

Net losses of CCG

Source: Public Works and Government Services Canada

value for the sale of CCG, with minimum risk and liability for the government, and to minimize the impact on the printing industry while securing job continuity in the private sector for as many of its employees as possible. The Minister reiterated the position that the government was committed to competition, freedom of choice and fairness, and therefore would not offer the buyer of CCG any guarantee of business. Managers in individual departments would continue to choose the best-value supplier for printing services.

First privatization of a common services organization

20.23 The sale of CCG was the first privatization of an optional internal services unit in the Government of Canada and also the first unit that was not

privatized as a legal entity. The government had no previous experience in this type of privatization. Earlier privatizations had involved mostly selling shares of Crown corporations such as Teleglobe Canada, Air Canada, Petro-Canada and Canadian National Railway. This time the government sold assets, rights and privileges.

20.24 It was also the first time that a special operating agency had been sold. In a study of SOAs by the Auditor General of Canada and by the Secretary of the Treasury Board in 1994, it was observed that the SOA initiative might best be seen as an alternative service delivery regime, and also as a transitional state that could eventually lead to more independent organizational forms within the government or in the private sector.

Exhibit 20.3

List of the Business Units

Business Units Privatized	Sales for 1995–96 (\$ millions)	Staff on 31 March 1996
Main Plant in Hull	29.6	238
Distribution Logistic Services	23.4	113
NCR Printing Centres Division	28.6	197
Atlantic Region Printing Centres	3.2	17
Ontario Region Printing Centres	5.2	30
Quebec Region Printing Centres	1.9	15
Pacific/West Region Printing Centres	5.8	37
Subtotal	97.7	647
Functions to be retained by Canada	12.7	80
Editing and composition of the Canada Gazette		
Crown Copyright administration		
Depository Services Program		
Reference Canada		
Map printing		
 Publishing 		
Functions to be dissolved	NIL	122
Corporate services		
TOTAL	110.4	849

Source: Office of the Auditor General

Focus of the Audit

20.25 Our audit objectives were to review:

- the openness and transparency of the privatization process;
- the value obtained and terms agreed with the purchaser;
- the control over the transfer of assets and liabilities to the new owner; and
 - the costs of the privatization.

We also examined human resource considerations.

- **20.26** The decision to privatize CCG was made by the government in April 1996. We did not examine the merits of the decision.
- 20.27 We conducted this audit by taking into account the objectives and parameters set by the government. Our audit work focussed on the period beginning with the Treasury Board decision of 16 May 1996, which approved PWGSC's submission for the divestiture of CCG, up to the closing of the transaction on 7 March 1997.
- 20.28 The fieldwork of this audit was completed in June 1997. The government is providing financial and information technology services to the purchaser on a cost recovery basis until December 1997. It is too early in the transition stage to offer any conclusion about whether measures adopted by management to identify and recover these costs are adequate.
- **20.29** Further details on our audit objectives, criteria and approach are presented in **About the Audit** at the end of the chapter.

Observations and Recommendations

Specifics of the Transaction

- **20.30** In the sale of CCG, the government sold physical assets, rights and privileges.
- **20.31 Physical assets**. Physical assets included fixed assets (mostly printing and office equipment) and the inventories.
- **20.32 Rights.** The rights sold were the Logo, the CCG Wordmark and the technology.
- 20.33 Privileges. Under the terms of the agreement, the government implemented the Privileged Administrative Arrangement (PAA), which will allow departments and agencies to do business with St. Joseph Corporation for a period of five years without soliciting bids or obtaining Treasury Board approval for contracts up to \$100,000. Contracts below this threshold represented about 95 percent of CCG's business.
- 20.34 The agreement also includes Accommodation Arrangements for the purchaser's occupancy of leased space in 60 premises across Canada that were occupied by CCG. This will allow the purchaser to retain the advantage of collocating with its government customers.
- 20.35 Through these arrangements, the government essentially has recreated the business environment in which CCG operated. It provides the new owner with easier access to government business for five years (in their dealings with contractors other than St. Joseph Corporation, departments are governed by government contracting regulations that require procurement needs for goods and

The government has recreated the business environment in which CCG operated.

services to be tendered). The government has agreed to explain and promote the PAA as a procurement option for departments and agencies.

20.36 This five-year business advantage, which was offered to all prospective purchasers, will give the winning bidder time to structure its operations to face full market competition. However, the government did not offer any guarantee of business since government departments and agencies still retain the right to choose the best-value supplier for printing services provided that they go to tender should they wish to contract with a contractor other than St. Joseph Corporation.

Sale price

20.37 In consideration for these assets and entitlements, the purchaser agreed to pay or otherwise assume liabilities aggregating \$10.7 million. This sale price comprised a cash payment, assumption of liabilities by the purchaser and an amount for cost avoidance by the Crown. The detailed breakdown of the sale price is shown in Exhibit 20.4.

Exhibit 20.4

Components of Payment

	\$ millions
Payment in cash	\$5.0
Assumed liabilities	
Accrued vacation	\$0.6
Transfer of rights in software	\$1.4
Subtotal	\$7.0
Cost avoidance in salary offers	\$3.7
Total Price	\$10.7

Source: Office of the Auditor General

Offers of employment

20.38 St. Joseph made 570 offers of employment with a guarantee of employment of two years (551 operational employees of the business units, including 248 at the Main Plant in Hull and 19 from the Corporate Services Division). Further details about offers of employment are given in Exhibit 20.5.

Sale Process

20.39 Once the decision to investigate the feasibility of privatization had been made, the CCG privatization team led the process. It developed principles to guide management decision making until such time that government direction was received. A team comprising officials from the central agencies, PWGSC and the Department of Justice, supplemented with private sector financial and audit advisors, drafted detailed bid evaluation and selection criteria that were approved by the government. The bid evaluation team also consisted of individuals from different departments. The financial advisor controlled liaison with the bidders.

20.40 CCG followed a competitive sale process and the invitation to submit bids was made through the Open Bidding System, the government's electronic advertising system. Exhibit 20.6 shows the different stages of the sale process.

Bid evaluation

20.41 Given the government conditions of sale, best value was obtained. CCG hired a private sector financial advisor to assess the value of the business units to be sold and to advise on the sale strategy. According to the advisor, the real value of CCG, as a government common services agency, resided in its proximity to customers (collocation), its goodwill, its experienced employees with strong client relationships, employee

security clearances and, most important, the ability of government departments and agencies to procure from CCG without tender.

20.42 At the same time, however, CCG did not have significant assets such as real estate, as it occupied government-leased premises. Although its printing equipment was well maintained, it was not modern. CCG was incurring losses. Its only client was the Government of Canada. However, with sales of nearly \$100 million in 1995–96, we estimate that CCG retained about 20 to 25 percent of the government printing business market share.

20.43 The government ruled out the option of offering long-term contracts to the purchaser or offering a guarantee of business. Although such an offer might have generated a higher selling price, it would have been inconsistent with Treasury Board common services policy and would have limited the ability of government departments and agencies to choose the best-value suppliers.

20.44 Nonetheless, in order to sell under the best conditions possible, the government offered some transitional incentives to prospective purchasers in the form of special access to all departments and agencies, as described earlier.

20.45 The government set a minimum expectation or preference for the sale of CCG units — minimum of 400 job offers (150 at the main plant in Hull) for a minimum period of two years, and an amount of \$13 million cash or equivalent benefits or savings for the government.

The St. Joseph Corporation bid met the government's expectations.

20.46 In taking into account Work Force Adjustment costs for employees not offered a job and special incentives payments made to employees who accepted a job, the best-value bid would be the one that resulted in the least cost to the government. Factors other than cost, including financial capacity, the quality of jobs offered and risk factors, were also taken into account. Points were attributed to both cost and other factors, and the St. Joseph bid scored the highest number of points.

20.47 After the evaluation of the bids had been finalized, CCG found out that it had overstated the value of the St. Joseph bid by \$464,000. This was caused by an incorrect classification in CCG's human resources records of certain employees between operations and corporate services. CCG recalculated the bid's points and concluded that the overstated amount was insufficient to offset the point advantage of the St. Joseph's bid over the next finalist's bid. This increase in the net implementation cost of St. Joseph's bid was not reflected in the information provided to the Treasury Board. However, the full impact of Work Force Adjustment costs of accepting the St. Joseph

The best-value bid would be the one that resulted in the least cost to the government.

Exhibit 20.5

Status of Jobs Offered by Buyer

	Accepted Offers	Refused Offers	Total Number of Offers	
Operations staff	533	18	551	
Corporate services staff	15	4	19	
Total	548	22	570	

Source: Public Works and Government Services Canada

Corporation bid were calculated and disclosed to the Treasury Board.

Sale process properly managed

20.48 In conclusion, we noted that the sale process was properly managed, transparent and open to all potential buyers. We found support and documentation on all aspects of the process. All potential buyers received the same information, and the evaluation and selection criteria were applied consistently to all bids received.

20.49 In our opinion, the evaluations of both non-binding and binding offers were conducted in accordance with the stated process and resulted in a proper evaluation of the bids.

Final terms and conditions of the deal

20.50 Before closing the deal in March 1997, CCG and St. Joseph Corporation made an amendment to the Agreement of Purchase and Sale and, as a result, the number of job offers to be made for corporate services employees was reduced

from 30 to 19. We were informed that only 19 individuals who had the skills needed by the purchaser were available to transfer to St. Joseph Corporation. The savings in Work Force Adjustment costs of 11 job offers were calculated at about \$150,000 during the bid evaluation process. Again, even if that fact had been known at the time of bid evaluation, it would not have changed the result of the competition. But, as a result of this amendment, the government will pay some extra Work Force Adjustment costs for individuals who will not find a job elsewhere in the government. However, we consider that this amendment resulted from a negotiation process that is normal in such a transaction. We were advised by CCG that only a few of the corporate services employees will not find a job elsewhere in the government and will thus be entitled to Work Force Adjustment benefits.

20.51 In conclusion, we found that the evaluation of the business units carried out by the financial advisor to assist the

Exhibit 20.6

Chronology of Sale Process

Stages		Date	
1.	Treasury Board approval of the process	16 May 1996	
2.	Invitation to submit bids (360 interested parties)	13 June	
3.	Prequalification (86 potential buyers)	13 June – 16 August	
4.	Non-binding process (23 bids received, 7 selected for next stage)	Due 21 August	
5.	Binding offers (5 submissions)	Due October 16	
6.	Evaluation of bids (3 finalists)	16–30 October	
7.	Selection of best bid (St. Joseph Corporation)	31 October	
8.	Final due diligence	4 November – 12 December	
9.	Negotiations of terms and conditions for agreement	November	
10.	Treasury Board approval	12 December	
11.	Agreement of Purchase and Sale	13 December	
12.	Job offers to operations staff	6 January 1997	
13.	Job offers to corporate services staff	14 February	
14.	Closing of deal	7 March	

government in designing the privatization plan and the resulting valuation report were most useful. We believe that the approach used for estimating the fair market value of each business unit (discounted unlevered free cash flow method) was the most appropriate method, given the history of CCG's lack of profit.

20.52 As discussed earlier, the divestiture process was competitive and attracted a significant number of bidders from the printing industry. We concluded that, despite the modifications noted above, the bid submitted by St. Joseph Corporation represented the best value that could be obtained at that time under the parameters and conditions of sale specified by the government. A corporate profile of St. Joseph Corporation is included in Exhibit 20.7.

Human resources records

20.53 In a privatization process, human resources are an important part of the value of the business that is for sale, and the number of resources that can be absorbed by prospective purchasers is a significant element of the value the government is obtaining from the purchaser in terms of costs avoidance. It is therefore critical to have accurate and complete records about the work force for the prospective purchasers to prepare their bids. The data about CCG's work force were not adequate for the special needs of the privatization (support of bid evaluation and job offer processes). This caused several problems during the entire process.

20.54 In future privatizations, special attention should be paid to human resources records and specific measures should be taken early in the process to ensure the accuracy and completeness of the records to facilitate the sale process.

Benchmark used for bid evaluation

20.55 A general test applied to the sale of a government entity is that the government should receive greater value from the sale than it would receive from retaining ownership, taking into account the financial and other implications attached to continued ownership.

20.56 One of the options that the government examined for CCG was downsizing the organization. In analyzing this option, the government assumed that CCG would continue as a special operating agency with certain operational modifications, that is, the size of its work force would be reduced and CCG would be allowed to use more efficient pricing strategies to compete with the private sector for government business. This option is known as the competitive model.

20.57 The government used the net implementation cost of the competitive model as a benchmark to assist in evaluating the bids. In the event that it became apparent during the sale process that the government would not get at least what was expected under the competitive model, CCG would have to return to the

The bid submitted by St. Joseph Corporation represented the best value that could be obtained at that time under the conditions of sale set by the government.

ccg's human resources records were not adequate for the special needs of the privatization.

 Canadian, family-owned business founded 40 years ago

- Based in Toronto
- 550 employees and annual sales of \$120 million
- Customers include large corporations as well as governments and Crown corporations
- Advanced printing operation at leading edge of technology
- ISO 9002 designated company
- By acquiring CCG, St. Joseph Corporation is virtually doubling in size and will have offices across Canada

Exhibit 20.7

Profile of the Successful Bidder

– St. Joseph Corporation —
(before acquiring CCG)

The calculation of the net implementation cost of the competitive model used as a benchmark during the bid evaluation process was questionable.

Certain costs to be absorbed in other federal government entities were not included in CCG's analyses of the various options for the organization's future.

government for further direction on its future.

We found that the calculation of 20.58 the net implementation cost of the competitive model used as a benchmark during the bid evaluation process was questionable. The portion of the cost of the competitive model relating to future annual operating results took into consideration only financial forecasts for the next three years (discounting period) where losses were expected. CCG's calculation did not include the present value of future annual cash flows following the discounting period for which profits had been forecast. The other bidders without doubt considered profitability on a longer term than CCG did.

20.59 A method similar to the one used in the valuation report prepared by the financial advisor, adding terminal value and discounting operating results over a longer term, may have been more appropriate for the calculation of the net implementation cost of the competitive model to obtain a benchmark more comparable with bids received.

20.60 For future privatizations, the government should ensure that bids received are compared with reliable benchmarks that have been thoroughly assessed and reviewed.

Control over Transfer of Assets

20.61 We found that there was satisfactory control over the transfer of the CCG's assets and liabilities to the purchaser. Adequate revenue and expense cut-off procedures were used at closing to ensure that the government collected what it had earned and paid only its own costs to the date of transfer. The net book value of assets sold amounted to \$7.4 million

(\$4.6 million for inventories and \$2.8 million for capital assets).

20.62 PWGSC Real Property Branch took the necessary measures to arrange for 60 accommodation leases at fair market value with St. Joseph Corporation.

20.63 One problem was encountered before the privatization process began. The asset records and the physical asset count done by CCG in preparing for the privatization could not be reconciled. Assets of \$350,000 were written off. These were items with a book value exceeding \$1,000 each.

Costs of Privatization

20.64 The December 1996 estimate of the privatization costs provided by CCG was \$45.3 million. This amount included costs of the sale of CCG's business units, the transfer to government departments of the functions not privatized, the closing down of the special operating agency, as well as Work Force Adjustment costs and operating losses incurred during the privatization period. We have not audited these costs. Exhibit 20.8 gives the breakdown of the privatization costs.

20.65 The organization had started to downsize in 1995 and related Work Force Adjustment costs are included in the cost of privatization. The total costs of Work Force Adjustment and Special Incentives programs appear in Exhibit 20.9. These costs will be absorbed by the CCG revolving fund.

20.66 Other costs resulting from the privatization and not included in the above-noted estimated figure will be absorbed by the government.

Waiving of actuarial reduction on pension allowances

20.67 The actuarial estimate made by the Treasury Board of pension penalties

aived for government staff taking early retirement is \$125,000 per employee. We estimate that for CCG the cost ranges from \$20 million to \$25 million; this money will come out of the government superannuation account. Although CCG disclosed the fact that eligible employees of CCG would have access to the pension waiver, it did not provide estimates of the costs. The inclusion of this cost element would bring the total cost of privatization between \$65 million and \$70 million from CCG's latest estimate of \$45 million.

20.68 In addition, costs related to waiving of pension penalties were not included in CCG's analyses of the various options for the organization's future. The inclusion of this cost element could have had an impact on the results of the cost/benefit analyses conducted.

Pension protection clause

CCG employees who transferred to St. Joseph had to leave their pension with the government superannuation account. The government designed and implemented a pension protection clause for employees transferred to the private sector. In virtue of this clause, these employees will have their period of service with St. Joseph Corporation added to their period of service with the government for the purpose of determining pension eligibility. This means that a certain number of employees will be eligible for their pension earlier than if this clause had not been approved. (The government pension plan stipulates that an employee is entitled to an unreduced pension if he or she has a minimum of 30 years of service and is at

	\$ Millions
Work Force Adjustment costs ¹	38.1
Operating losses incurred	7.9
Project management costs ²	11.7
Transition costs ³	15.1
Gross Costs of Privatization	72.8
Realization of net assets and liabilities ⁴	(20.5)
Proceeds from sale	(7.0)
Net Cost of Privatization	45.3

Notes:

Exhibit 20.8

Estimated Costs of Privatization (not audited)

For the privatization period from 1995–96 to 1997–98

Source: Public Works and Government Services Canada

¹Details given in Exhibit 20.9.

²Costs incurred for planning and implementing the privatization decision (major components are the Privatization Secretariat, the Privatization Implementation Group and the management of Human Resources).

³Various costs incurred as a result of the privatization of CCG's business units, of the transfer to government departments of some functions and of the closure of the remaining CCG's functions (type of expense includes, for example, the six month salaries for job search paid to corporate services employees not hired by the purchaser and salaries paid to some operations employees in the months preceding their departure or retirement).

⁴Mainly accounts receivable net of accounts payable.

least 55 years old; otherwise the employee has to wait until the age of 60 to get an unreduced pension.) This provision is another cost to the government superannuation account that has not been included in the calculation of divestiture costs.

Income tax considerations

20.70 The purchase price includes a cost avoidance item of \$3.7 million, the value of making offers of employment to 552 employees at 100 percent of prevailing salaries instead of 86 percent as initially bid. This is the amount that the government would have had to pay to employees if the offer had remained at 86 percent. Indeed, the calculation of this

amount reflects the fact that the CCG Work Force Adjustment program would have required the government to assume salary differences for periods up to 18 months.

20.71 We saw no evidence that the Crown analyzed the tax implications of this element or other elements of the price structure and their potential impact on government tax revenues.

20.72 In future privatizations, cost/benefit analyses of options and cost estimates prepared by the government should include all direct and indirect costs to be absorbed by government departments and entities to the extent that they are material and can be practically assessed.

Exhibit 20.9

Work Force Adjustment Costs 1995–96 to 1997–98 (not audited)

As at 31 March 1995, there were 1,080 CCG staff. In addition to the 970 who have left CCG, 80 transferred with the functions retained by the government and 30 have found or are seeking alternative employment.

548 Employees Accept Job Offers	December 1996 Estimate \$ Millions
Compensation for accepting different benefits	10.0
Salary top-up	0
Severance pay	6.1
Unused vacation	1.9
Subtotal	18.0
183 Employees Receive Early Retirement Incentives	
Pay in lieu of unfulfilled surplus period	4.0
Severance pay	4.3
Unused vacation	0.2
Separation benefit	1.4
Subtotal	9.9
239 Employees Receive Early Departure Incentives	
Lump sum payment as a compensation for leaving	6.8
Severance pay	2.2
Training allowance	0.5
Unused vacation	0.5
Service allowance	0.2
Subtotal	10.2
Total Work Force Adjustment Costs	38.1

Source: Public Works and Government Services Canada

Human Resources Considerations

Work Force Adjustment program

20.73 In April 1993, CCG became a separate employer under the *Public Service Staff Relations Act*. CCG employees had different classifications and salary scales than the rest of government. Also, because CCG was a separate employer, the Treasury Board Work Force Adjustment Directive did not apply to its employees.

20.74 The Treasury Board, CCG and the unions worked at establishing a Work Force Adjustment program for CCG. As a result of a series of government decisions between February 1995 and December 1996, the CCG program contained provisions very similar to those of departments and agencies subject to the Treasury Board Work Force Adjustment Directive. It included a provision for a lump sum payment of six months' pay to employees who accepted a job offer from the purchaser, to compensate for differences in the purchaser's pension plan and in other benefits. It also contained provision for the payment of severance pay at lay-off rates, which is the highest rate for severance pay. Exhibit 20.9 provides the breakdown for Work Force Adjustment costs.

Early Retirement Incentive program

20.75 The Early Retirement Incentive (ERI) compensation regulations became effective for Public Service employees on 1 April 1995. By amendment to these regulations, ERI compensation was extended to CCG employees on 15 June 1995.

20.76 On 15 July 1995, the Chief Executive Officer (CEO) of CCG guaranteed ERI compensation to 50 key employees if they were eligible as of that

date and if they remained on staff until privatization. The granting of ERI compensation to others was restricted by CCG in October 1996, because the number of employees remaining was approaching the level needed to maintain CCG as a viable entity.

20.77 Using the Treasury Board model as a guide, we determined that the CCG Work Force Adjustment program was adequate and our test on a sample of cases revealed that they complied with the conditions of the program.

20.78 The ERI program was in place for employees who would not be offered employment by the purchaser. Thus the CEO's guarantee of ERI compensation to 50 employees would appear to be an inconsistent application of the program. However, the ERI regulations specify that eligibility may be extended by the deputy head as required to meet operational requirements. The guarantee by the CEO meets this condition.

20.79 The October 1996 restriction on granting ERI compensation is reasonable. It was done to maintain CCG as a viable operational entity and in anticipation of offers of employment being made by St. Joseph Corporation to a substantial number of employees. Such offers, when made, would negate eligibility for ERI compensation. Those not receiving such offers would continue their entitlement to compensation.

Job offers

20.80 In general, we found that the approach to determining the final number of people receiving offers from the purchaser was fair and consistent.

20.81 The job offers by St. Joseph Corporation were 100 percent of substantive salaries. The letters of offer to

The CCG Work Force
Adjustment program
was comparable with
the programs of
departments and
agencies subject to
the Treasury Board
Work Force
Adjustment Directive.

employees conformed with the Agreement of Purchase and Sale.

Conflict of Interest Policies

Employee takeover groups

The sale process allowed 20.82 employees to submit bids. Employee takeover (ETO) groups were reimbursed up to \$25,000 for expenditures on financial and legal advice required to develop their proposals. Their bids were considered at the same time and on the same basis as all others. The "Code of Conduct for CCG Employees" was in force and CCG issued "Supplementary Guidelines Regarding Employee Takeover Groups" in 1996. Employees were required to certify that they had read the Code and to disclose any activity that could place them in a situation of conflict of interest, such as participation in an ETO group.

20.83 Certain participants in ETO bids who occupied sensitive positions within CCG were temporarily reassigned to PWGSC by CCG in order to protect the integrity of the sale process and the employees from potential criticism.

20.84 We found that CCG's policy adequately described the risk management measures for ETO bids, and those measures were applied.

Individuals involved in the privatization process

20.85 St. Joseph Corporation needed personnel in areas such as human resources, information technology and finance to complete its management team for the newly acquired entity. It therefore made offers of employment to corporate services employees in February 1997.

20.86 After the Agreement of Purchase and Sale was signed (13 December 1996),

St. Joseph Corporation approached the Crown for permission to make job offers to two employees with close involvement in the privatization process. The Crown gave the Corporation this permission. We found that, while CCG obtained legal advice and took precautionary steps, these individuals participated in some discussions toward the end of the process, before closing of the agreement (7 March 1997).

20.87 CCG advised us, however, that from the moment these individuals were approached, they participated only in providing information and not in any decision making affecting the remainder of the privatization process (for example, the job offer process, and compliance with closing conditions). We noted that while the appearance of some conflict of interest existed, there was no evidence of any actual conflict occurring.

20.88 While we recognize that one objective of the privatization was to transfer as many jobs as possible to the purchaser, individuals having a sensitive role in a privatization process and who accept an offer of employment from the purchaser should not be allowed to participate in any further discussions with the purchaser, in order to remove any appearance of and potential for conflict of interest.

Experience in Other Jurisdictions

20.89 Privatizing government internal services organizations is complex because the business units to be sold are not always adequately defined or severed from the rest of the government. The process is also difficult because of the various stakeholders' objectives and the sometimes conflicting interests.

20.90 Other countries have privatized their internal printing services. We are aware of at least two examples where

difficulties encountered in the privatization process led to full inquiries: the British government's sale of Her Majesty's Stationery Office (HMSO) and the privatization of the Government Printing Office in New Zealand.

20.91 In the case of HMSO, press reports indicated that the sale price was less than a third of that initially expected and the successful buyer was allowed extra time to renegotiate the price after being named the preferred bidder. A month after the privatization, the new company announced that the work force would be reduced by more than a third and that additional work force adjustment costs for staff could not be ruled out. The National Audit Office has confirmed that it is carrying out a full inquiry into the transaction.

20.92 Similarly, the Government of New Zealand inquired into the circumstances surrounding the sale of its printing office. Concerns were raised about the length of time it took for the process, which caused additional costs for the government and led to a reduction in the sale price.

Conclusion

20.93 It is too early to predict whether the privatization of CCG will be a success in the longer term and whether all of the obligations under the agreement will be met. However, our review of the privatization process shows that it was open and transparent and that it was properly managed within the context of the sale conditions of the government.

20.94 The government had to consider various stakeholders' interests, such as value for the taxpayers, fairness for the prospective purchasers and employees, and jobs for employees. These objectives

and considerations sometimes conflicted and their resolution depended on the respective weight placed on them. From a public policy perspective, fairness and jobs were important factors, but resulted in costs (such as Work Force Adjustment costs) exceeding those that would have been incurred in a private sector transaction.

20.95 The privatization was achieved within a reasonable period of time. The initial target was to complete the sale within 36 months. The period was revised to 19 months and it actually took 25 months to privatize CCG from the Budget of February 1995 to the closing in March 1997. Delays encountered were, among other things, to ensure that the government could comply with its various trade agreements, and comply with the Work Force Adjustment program, which requires that employees be given 60 days to analyze job offers and make a decision.

20.96 Completing a privatization in the shortest possible period is essential because of the uncertainty that such a process creates and the difficulty of maintaining the morale of the work force, as well as the challenge of maintaining the business volumes (especially for an optional service), which are essential to obtain maximum value for the entity. CCG's gross revenues generated by the business units that were sold went from \$97.7 million in 1995–96 to \$80.1 million in 1996–97 (on an annual basis). This represents a reduction of 18 percent for the last year of operation.

20.97 Some key success factors. The following factors contributed to the overall success of the privatization of CCG.

20.98 The fact that CCG was established as a special operating agency in 1990 allowed better severance of the organization from the rest of government

We noted that the sale process was properly managed, transparent and open. However, it is too early to predict whether the privatization of CCG will be a success in the longer term.

and provided CCG with some valuable experience in operating in a quasi-commercial environment as a stage on the way to privatization.

20.99 The identification and resolution of authority and policy issues and the extensive consultation conducted with all stakeholders before starting the sale process were essential, especially as there was no previous government experience or privatization framework to draw upon.

20.100 The openness and transparency of the process was a success factor.

20.101 The many dimensions of an exercise such as this one require diversified expertise. The presence of advisors from central agencies and other departments as well as external consultants to give advice on legal, financial, audit and fairness matters contributed to the results.

20.102 Responsibility was given to the privatization team to make or obtain decisions related to the sale of CCG and to resolve procedural difficulties as they arose. This reinforced accountability for results in this privatization endeavour.



About the Audit

Objective

The objective of our audit was to examine the privatization of the Canada Communication Group in order to determine whether appropriate procedures were followed to protect the interests of the government and taxpayers and to ensure that the process was well managed, open and transparent. We also wanted to identify the key lessons learned from the privatization.

Scope

Our examination focussed on the period from May 1996 when the privatization process was approved to the actual transfer to the purchaser on 7 March 1997. The scope of the examination did not include the decision to privatize. It consisted of interviews with CCG management and other involved parties, the review of relevant documents and the tests that we considered necessary.

We did not audit any of the bidders and accordingly express no opinion on their activities.

Criteria

Sale Process

We expected that the sale process would be well managed, open and transparent.

Bid Evaluation

We expected that the best-value bid would be the one that resulted in the least cost to the government, and that non-cost factors would also be considered in determining the best bid.

Control over Transfer of Assets

We expected that there would be adequate procedures and controls in place to monitor the transfer of assets and to ensure that there has been a correct allocation of revenue and expenses between CCG and the buyer.

Costs of Privatization

We expected that the costs would be appropriately disclosed to decision makers.

Human Resources Considerations

We expected that an approved Work Force Adjustment program would be implemented consistently across the Agency, and that conflict of interest would be appropriately managed.

Audit Team

Janet Hatt

For information, please contact Alain Boucher, the responsible auditor.



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Report of the Auditor General of Canada to the House of Commons

Chapter 21
Household Goods Removal Services
of the Federal Government

October 1997



Report of the Auditor General of Canada to the House of Commons

Chapter 21
Household Goods Removal Services
of the Federal Government

This October 1997 Report comprises 11 chapters and a Foreword and Main Points. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

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Chapter 21

Household Goods Removal Services of the Federal Government The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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Assistant Auditor General: David Rattray Responsible Auditor: Vinod Sahgal

Household Goods Removal Services of the Federal Government

Main Points

- 21.1 This audit was conducted in response to a request from the Standing Committee on Public Accounts.
- 21.2 Some 19,000 employees were moved by the federal government in 1995–96 one quarter of all moves by the van lines in Canada and several times more than the next-largest Canadian employer. The federal government is well placed to obtain favourable terms from the moving industry.
- 21.3 The tariff paid by the government has been falling significantly in recent years. A number of factors have contributed to this decline, including introduction of the competitive bidding process in 1992. The tariff is below that paid by all but a few Canadian organizations procuring similar services. Nevertheless, there are a number of areas that warrant action.
- 21.4 The level of satisfaction of government employees with the quality of service was below that of relocated employees of other Canadian organizations. One reason is that emphasis has been placed mainly on obtaining the lowest price, not the "best value" a concept based on both price and quality as measured in terms of employee satisfaction.
- 21.5 The existing contracting arrangements, which incorporate a formula for allocating business among qualified bidders, have proved to be brittle. For two consecutive years, problems have arisen in either the tendering or the implementation phase.
- 21.6 A potential exists for overcharging due to "weight bumping" as well as excessive weight for other reasons. The inherent risk that billed weights can be manipulated is high, yet controls to prevent this are weak.
- 21.7 The number and cost of personnel employed to administer household goods removal activities have not been falling despite the significant decline in volume of moves. Potential efficiency gains have been identified that could achieve savings of an estimated \$1.5 million yearly. Enhanced use of information technology, centralization, simplification of rules and regulations, and elimination of unproductive activities are some areas that need action.
- 21.8 There are other areas of potential cost savings. For instance, yearly savings of \$1 million to \$2 million in operating costs may be possible if a feasible alternative to weighing shipments can be found for pricing moves.
- 21.9 The employment of several former senior National Defence officials by the moving industry has created a perception of non-arm's-length relationships. Further, a specific situation being looked at by National Defence may determine whether or not any abuse actually occurred.



Introduction

Government moves of household goods involve several players

21.10 For 30 years the Government of Canada has operated a central system of contracting for the relocation of household goods. The system is overseen by the Interdepartmental Committee on Household Goods Removal (IDC), chaired by National Defence (DND) and comprising DND, the RCMP, and Public Works and Government Services Canada (PWGSC).

Treasury Board issues the 21.11 Relocation Policy that governs the relocation of government employees of departments, agencies and Crown corporations as listed in the Financial Administration Act. DND and the RCMP have their own policies for the relocation of their members. The IDC establishes the Statement of Work for transportation services. PWGSC is the contracting authority and is responsible for establishing contract requirements. Each IDC member department is responsible for the administration of contracts (including the ordering of moves, audit and payment of invoices).

21.12 There are approximately 3,000 carriers of household goods in Canada; about 500 of them are affiliated with van lines. There are four major van lines in Canada, each comprising a number of carriers. Originally, the main function of the van lines was to co-ordinate trips to and from a destination so the carrier did not return empty. Because the federal government contracts mainly with the van lines instead of with individual carriers, van lines are the prime contractors for government work and the carriers or agents are subcontractors.

21.13 Approximately 60 percent of federal government moves are made in three summer months, June to August. Some of the capacity built up to handle this peak load may understandably be underused in the rest of the year.

21.14 All federal government departments and agencies cover the costs of relocating the household goods of staff who have been assigned to new locations. In 1995–96, by far the largest number of moves was undertaken by DND (14,000), followed by the RCMP (2,200). PWGSC managed 2,600 moves for other departments.

21.15 The number of moves has been declining in both the government and the private sector (Exhibit 21.1). During this period of decline, the federal government's share of moves handled by van lines has remained fairly constant at about one quarter of the total number (Exhibit 21.2).

Focus of the audit

21.16 On 20 June 1996 the Standing Committee on Public Accounts wrote to the Auditor General and asked him to investigate specific matters associated with the federal government's household goods removal services. The Auditor

Public Works and Government Services Canada is the contracting authority and is responsible for establishing contract requirements.

Van lines are the prime contractors for government work and the carriers or agents are subcontractors.

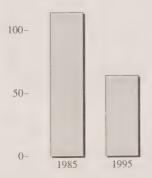


Decline in the Number of Moves, 1985–1995

Over a ten-year period the four major van lines' shipments declined from about 114,000 to 64,000.

Source: CERC Annual Meeting, 1996

Number of Moves (thousands) 150-



From 1989 to 1996, the tariff paid by the federal government for the relocation of household goods showed a cumulative decrease.

General responded on 8 July 1996, agreeing to conduct a value-for-money audit of household goods removal services that would include the specific matters raised by the Committee (see Appendix for the exchange of correspondence).

21.17 Further details on the audit objectives, scope, criteria and approach can be found at the end of the chapter in the section **About the Audit**.

Observations and Recommendations

Value Obtained under Contracting Arrangements

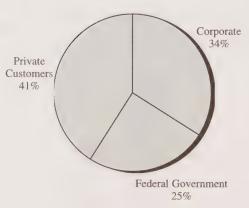
21.18 Some 19,000 employees were moved by the federal government in 1995–96 — one quarter of all moves by the van lines in Canada and over 18 times more than the next-largest Canadian employer. The federal government is well placed to obtain favourable terms from the moving industry.

Prices paid by the government are comparatively low

21.19 From 1989 to 1996, the tariff paid by the federal government for the

Exhibit 21.2

Federal Government Share of Total Volume of Moves Handled by Van Lines in 1995



The federal government's share of total moves has remained fairly constant at 25 percent.

relocation of household goods showed a cumulative decrease of about 30 percent in current dollars, or close to 50 percent in 1989 constant dollars adjusted for inflation (Exhibit 21.3). However, prices negotiated for 1997–98 are higher on average than the previous year's by about 14 percent.

21.20 Changes made in the government procurement system in 1993 and 1995 contributed to the decline in tariff. Other factors at work include the deregulation of the industry coupled with a rapid decline in the number of moves in the federal government and elsewhere, and a consequent overcapacity in the industry.

21.21 The federal government pays a tariff significantly lower than the tariffs paid by other organizations we contacted. No other organization in Canada contracts for anything close to the number of moves by the federal government, so one would expect the tariff it pays to be relatively low.

21.22 The federal government's transportation costs have not declined as much as tariffs, since the average weight of a household of goods has risen over the same period. From 1993 to 1996, the average weight of government shipments increased (Exhibits 21.4 and 21.5). It is reportedly now slightly higher than in the corporate sector. Average weights for both government and corporate moves are in the order of twice the average for moves paid for by individuals. Industry officials attribute this difference partly to the fact that when individuals pay they are far more selective in what they choose to move.

Greater emphasis on employee satisfaction needed

21.23 From our review of best practices in other Canadian organizations as well as in selected organizations in other

Source: CERC Annual Meeting, 1996

countries, we noted that in almost all cases the notion of "best value" is the primary consideration in the contracting process — where "best value" is based on both price and quality as measured in terms of employee satisfaction.

21.24 We found that the federal government has given this aspect less attention. It has defined quality of service largely as the carrier's conforming with specified standards, for example, for packing and unpacking. The IDC has used an employee feedback form to ascertain satisfaction with moves, but this information has been collected inconsistently and has not been analyzed sufficiently.

21.25 PWGSC assesses the contractor's broad capability to comply with regulations governing move procedures, but not its past performance in terms of customer satisfaction with completed moves. A bidder on a contract must obtain a minimum number of technical points but, after this initial screening of eligibility, employee satisfaction in the past has had limited influence on who is awarded how much work. There is little

incentive provided to movers to ensure that government employees are fully satisfied.

21.26 From our look at best practices, we concluded that there are a number of ways information on customer satisfaction can be used in the contracting process by providing a pricing incentive or penalty; by providing an increased share of business, particularly by granting more off-peak business to contractors that deliver good customer satisfaction; by considering the past track record of customer satisfaction when awarding each contract; or by tracking customer satisfaction with different contractors and providing the information, with a choice of contractors, to the relocating employee or the employer.

Employee satisfaction is below that of other organizations

21.27 We conducted a survey to assess the extent to which federal government employees were satisfied with the quality of their household moves. The survey addressed several aspects such as the pre-move briefing, the packing, loading, unloading and unpacking of their furniture

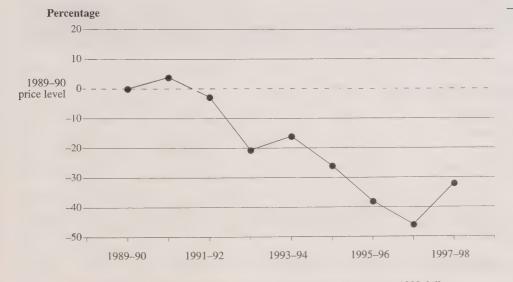
No other organization in Canada contracts for anything close to the number of moves by the federal government, so one would expect the tariff it pays to be relatively low.



The Effective* Tariff Paid by the Federal Government, 1989–90 to 1997–98

The effective tariff paid by the federal government has been declining over the last decade.

Source: OAG analysis in 1997 of 20 typical move scenarios using government tariffs 1989–90 to 1997–98.



* The "effective" tariff is a weighted average tariff expressed in constant 1989 dollars.

About two thirds of those we surveyed were satisfied or very satisfied; 18 percent were neither satisfied nor dissatisfied; dissatisfaction was highest with unpacking and claims settlement.

and effects, and the claims settlement process.

21.28 We found that about two thirds of those we surveyed were satisfied or very satisfied; 18 percent were neither satisfied nor dissatisfied; and 14 percent were either dissatisfied or very dissatisfied. Many factors can influence satisfaction, including whether or not the move is voluntary, but to have one in seven employees dissatisfied or very dissatisfied indicated room for improvement. Dissatisfaction was highest with unpacking and claims settlement. According to the IDC, the recent decline in the settlement amount (see paragraph 21.102) could reasonably be seen as a contributing factor.

21.29 We compared levels of satisfaction between government employees and employees of other organizations. Because of differences in the survey methodologies, only limited comparisons are possible. Given this

limitation, it appears that government employees were consistently less satisfied than employees of other organizations with the quality of the moving service, by a notable degree (see Exhibit 21.6). The government has not specified what level of customer satisfaction it expects. However, it expects that its development of performance measures will help to establish benchmarks for customer satisfaction.

Fairness and competitiveness of the system are at issue

21.30 The present contract framework to allocate business shares was introduced for the 1996–97 contract year based partly on the advice of the Competition Bureau. Until the current inquiry by the Competition Bureau is completed, the appropriateness of the business allocation system remains an open question.

21.31 In May 1996, the Bureau started an inquiry into allegations that one or more of the van lines had breached a 1983 order issued by the Supreme Court of

Exhibit 21.4

Comparison of Total Cost, Total Weight, Number of Moves, Average Weight per Move and Average Cost per Move

\$ 88,558	\$ 79,093	¢ 60 001	(22.2)
	+ , 0 - 0	\$ 68,884	(22.2)
155,345	146,471	145,338	(6.4)
22,933	20,505	18,855	(17.8)
6,774	7,143	7,708	13.8
\$ 3,862	\$ 3,857	\$ 3,653	(5.4)
	22,933	22,933 20,505 6,774 7,143	22,933 20,505 18,855 6,774 7,143 7,708

Between 1993–94 and 1995–96, the number of government moves of household goods decreased by 17.8 percent. However, during the same period, the average weight per government move increased by approximately 13.8 percent.

Note: Comparable data for 1996–97 were not available at the time of the audit.

Source: IDC

Ontario by preventing affiliated carriers from providing services to the federal government except through van lines. The four major van lines reportedly had entered into agreements to provide moving services to each other in areas where they were not represented, but would not enter into similar agreements with any other bidder on the federal government tenders.

21.32 Without commenting on competition issues presently being pursued by the Bureau, we can make some observations. With the exception of one competitive element, the PWGSC system of procuring relocation services for household goods is a "managed" system of work sharing. The work is allocated on a percentage basis among a small number of contractors. Whether the eligibility-to-bid requirements constitute significant barriers against new suppliers, especially smaller businesses, is also an open question. The system's one competitive element is that the largest share of business goes to the low bidder. Once the low bid is identified, the other bidders are asked to match it. PWGSC has sought a maximum of four bidders (a minimum of three) who are willing to match the low bid price, based on the IDC's belief that there is insufficient capacity with fewer than three suppliers.

21.33 We have several concerns about the workability of the process. First, as we have noted, price and not "best value" is the key determinant in allocating business among competing bidders. Employee satisfaction is not built into the selection of contractors.

21.34 Second, the bidders are not asked what percentage of government moves they can handle, and the lowest bidder is not necessarily awarded a volume of business to the full capacity that it is willing to commit to government work.

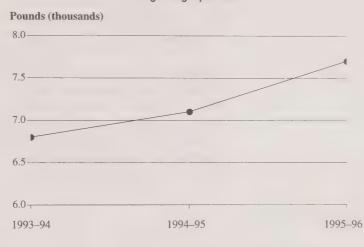
Bidders cannot offer different prices for different volumes of work or different levels of service, or for sub-packages of particular types or locations of moves. To participate in the work, bidders are required to meet the low bid price even though they may differ in their particular competitive advantages, volumes of work and levels of service. Smaller

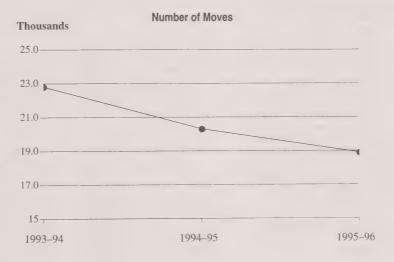
We have several concerns about the workability of the bidding process.

Exhibit 21.5

Government Removal Statistics
Over Time

Average Weight per Move





The number of moves is decreasing while the average weight per move is increasing.

Source: IDC

In May 1996, the
Competition Bureau
started an inquiry into
allegations that one or
more of the van lines
had breached a 1983
order issued by the
Supreme Court of
Ontario.

organizations that might be very capable of handling moves in one zone (say between Quebec and Ontario) are not able to bid on that basis. The "me too" concept does not match a particular carrier's capability with a particular move, nor does it sort moves into packages that might economically be handled together. However, DND is not convinced that changing its current approach would necessarily lead to better value for money.

21.35 Third, if contractors participate in the bidding process their only option is to bid as if they had the capacity to undertake the largest percentage of the work, although some do not have that capacity. Therefore, some may bid high enough to ensure that they do not win. They want to be in a position to match the low bidder, but for a smaller share of work. This gives the appearance, but not the reality, of full and open competition. Indeed, it would appear that only two bidders have been interested in obtaining

the largest share of business, so only those two bids have been aggressively priced.

21.36 Fourth, the contract could be more flexible. There is a need to encourage further innovation and piloting of new ideas. For instance, it may be timely to try other options for pricing moves (paragraph 21.98).

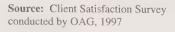
21.37 Finally, the bidding system has proved to be brittle. The structure depends on a sufficient number of bidders who both are qualified and agree to match the low bid. This has led to difficulties in the tendering process.

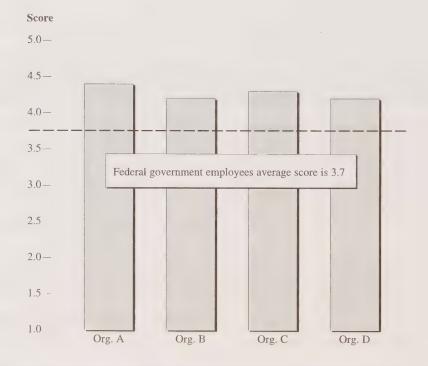
21.38 In tendering for the procurement of the household goods removal services for 1996–1997, for example, the government evaluated the capacity of the bidders to provide the required services. The low bidder, who was a new entrant, was reportedly unable to perform to the government's full satisfaction. Shortly after the start of the contract, the bidder was informed by PWGSC that it was

Exhibit 21.6

Overall Employee Satisfaction with the Quality of the Moving Service

The exhibit compares the average score given by employees for overall satisfaction with the moving services, where a score of 1 means "very dissatisfied" and a score of 5 means "very satisfied". Federal government employees, with a score of 3.7, are generally less satisfied with their move than employees of the four other organizations.





non-compliant, due to alleged non-performance by a subcontractor. Rather than face contract termination for default, the low bidder changed subcontractors to one of the van lines that had been unsuccessful in the original bidding.

- 21.39 In 1997, the same bidding process was followed. Again, problems resulted. This time only one other bidder was willing to match the low bid.

 Negotiations led to various changes that had the effect of increasing the previous year's tariff by about 8 percent before the third van line would agree to a new contract. The unsuccessful bidder challenged the process in court.

 Subsequently, a still higher price (by 14 percent) was negotiated, along with some changes in the percentage shares of work.
- 21.40 In addition to these questions about the workability of the bid matching approach, there are concerns about fairness. On the basis of its experience with the tendering process, PWGSC now believes that "the bid matching process is fundamentally unfair in that contractors are obligated to provide services at the lowest bidder's rates, regardless of their volume of business share."
- 21.41 A further concern of some in the industry is that contract awards have been announced about two months before the start of the contract period. Industry personnel argue that this provides insufficient time to adjust to potentially large changes in business share, and that this risk, too, may serve as a barrier against the entry of new suppliers. However, in the latest procurement the government let a two-year contract, which may provide for longer lead times at the next competition.
- 21.42 The business allocation system needs to be re-examined. A number of

alternative contracting structures are possible that could encourage more competitive bidding and service innovation (see Exhibit 21.7).

- 21.43 Public Works and Government Services Canada, in consultation with the Interdepartmental Committee on Household Goods Removal Services, should implement a fairer and more effective contracting arrangement that:
- gives greater weight to employee satisfaction with past moves in determining "best value";
- improves the fairness and competitiveness of the contracting arrangements, including concerns that may be raised by the Competition Bureau; and
- allows for innovation and piloting of new ideas.

Cost and Efficiency of Household Goods Removals Management

- 21.44 Household goods removal services are managed in-house at DND, RCMP and PWGSC, all members of the IDC. Apart from co-ordination through the IDC, each department manages its moves independently of the others, with activities split between headquarters and regional offices across Canada. DND has a network of 29 regional offices, RCMP has a separate network of 13 offices and PWGSC has 9, for a total of 51 regional offices.
- 21.45 The activities performed by each of the departments at its headquarters include planning and overall monitoring of the activities that are contracted out, and supervising those carried out in-house by regional offices. The activities in the regions include registering all information related to moves, communicating with contractors, providing assistance to relocating employees, monitoring and

There is a need to encourage further innovation and piloting of new ideas.

"The bid matching process is fundamentally unfair in that contractors are obligated to provide services at the lowest bidder's rates, regardless of their volume of business share."

— Public Works and Government ServicesCanada

The Interdepartmental Committee has very limited performance measures for assessing the efficiency and effectiveness of its activities.

controlling services performed by the contractors and verifying invoices. In PWGSC all invoices are verified and paid centrally.

Studies have been undertaken to improve efficiency and reduce costs

- **21.46** The IDC has been examining ways to reduce the cost of managing the household goods removal services since the early nineties.
- 21.47 Between 1991 and 1994, the IDC initiated three studies to analyze the cost of managing household goods removal services and to identify potential savings. One aspect examined was whether it would be more cost-effective to contract out certain activities to the private sector or to continue to manage them in-house. An interdepartmental senior review board

concluded, based on the studies, that a business case could not be made to contract out the management and delivery of the services and that in-house efficiency gains should be pursued.

- 21.48 The last internal study undertaken by the IDC on the cost of managing household goods removal services was performed in 1994. The study showed that it cost about \$5.6 million in direct expenditures (salaries and benefits) to manage 22,933 moves in 1993–94, reportedly involving some 123 full-time equivalents (FTEs). The cost per move at that time was \$242 and the number of moves per person employed in the function was 186.
- **21.49** We reviewed the IDC's most recent information on the cost of managing household goods removal

Exhibit 21.7

Some Alternative Systems of Move Management

Our discussions with industry and our review of best practices suggest that weaknesses in the present contracting structure could be resolved. We identified a number of potentially attractive alternatives, each with some advantages and disadvantages:

- Segmenting the national contract into a number of packages. Rather than a single national
 contract, the work could be subdivided into a series of packages based on traffic patterns (for
 example, one package might consist of all moves within a single region, another of all moves
 between that region and another region). Among other advantages, this would open up
 competition to firms not able to provide service nation-wide.
- Tendering individual moves. Another possibility is to tender each move separately, a practice used by Removals Australia, an agency that arranges government moves in Australia. The potential advantage is that attractive prices might be obtained if the tendered shipment could be loaded on a truck that would otherwise travel partially or entirely empty. One potential disadvantage is the cost of administering separate tenders for each move (although experience in Australia suggests that this need not be significant).
- Developing a standing offer list of firms. Rather than negotiate a large-volume contract, firms would provide a quote on the services they offer and their associated rates. Government departments and/or relocating employees could choose from among the available firms. Information could be added on levels of client satisfaction with each firm in previous moves. The U.S. General Services Administration has established such a system for use by U.S. federal agencies. This raises the question of whether firms not guaranteed specific business would offer a price and service combination different from what they would provide under a large-volume contract?
- Providing lump sum payments to employees as an alternative to a government-paid move. This approach, which could be provided to employees as a voluntary option, involves giving a non-accountable allowance to employees, who then directly engage a moving company or rely on 'do-it-yourself'. A pilot of such a system undertaken by DND concluded that the option was not viable. Our review of the pilot suggests, however, that the option could be considered for employees who are interested, even if this is a small proportion of government employees, at relatively little administrative cost and risk.

Source: OAG review of best practices

services at DND, RCMP and PWGSC. The total cost was \$5 million in direct expenditures (salaries and benefits) for 1996–97, involving the equivalent of some 110 person-years (67 military personnel and 43 civilians). The IDC has very limited performance measures for assessing the efficiency and effectiveness of its activities.

21.50 In 1995, a series of negotiations took place between DND and PWGSC on transferring the latter's move-management responsibilities to DND in order to consolidate management activities in one location to minimize overlap in responsibilities and duplication of work. This consolidation had not taken place at the time of the audit. In addition, discussions have begun for the transfer of the RCMP responsibilities to DND.

Government's management costs per move are comparatively high

21.51 The number of personnel and the total direct expenditures for managing the

household goods removal function have remained more or less constant from 1993–94 through 1995–96, while the number of moves has sharply declined (see Exhibit 21.8).

21.52 DND told us that it plans to continue to pursue additional efficiencies. In 1995, DND began in-house development of the Automated Move Management System (AMMS), aimed at moving from a largely manual system to a paperless contracting, invoicing and payment system. This system was expected to be operational on 1 April 1998; the most recent projection by DND is that the project will be completed by April 1999. The improved Automated Move Management System is now expected to save at least 30 full-time equivalents.

21.53 Industry officials informed us that van lines fully support the government's plans for automation. However, in their view the entire process needs to be reviewed before any further

DND told us that it plans to continue to pursue additional efficiencies.

Exhibit 21.8

Cost and Resources Used for Managing Household Goods Removal Services from 1993-94 to 1996-97

Year	No. of Moves	FTEs	Cost ¹	Cost/ Move	Moves/ FTE
1993–94	22,933	123	\$5.6 M	\$ 242	186
1994–95	20,505	123	\$ 5.6 M ²	\$ 271	167
1995–96	18,855	123	\$ 5.6 M ²	\$ 295	153
1996–97	*	110	\$ 5.0 M	*	*

Notes:

- Cost of salaries and benefits of personnel directly involved in the function.
- Departmental estimates of salaries and benefits of employees directly involved in the function, based on an internal study done in 1994.
- * The number of moves for 1996–97 was not available at the time of the audit.

Source: IDC management information systems and DND internal studies

The reweigh program at DND is performed only in a small number of locations and in a very limited way.

Results of our review of best practices suggest that not all of the activities provided are essential.

investment is made in developing the proposed system. They recommend continued and further consultation with industry on both process and technical design.

- 21.54 Some private sector organizations gave us data on the costs of managing their household goods removal services. One reported its average cost per shipment handled in-house at about \$200, while another reported a range of \$150 to \$180—both lower than in the federal government.
- 21.55 Fees charged by third-party companies generally range from \$200 to \$350 per move, depending on volumes and levels of service. It is important to note that reported federal government costs involve only salaries and benefits, not overhead costs, while third-party fees cover all costs and some provision for a profit margin.
- 21.56 As a further example, Removals Australia appears to manage a larger number of moves than the Canadian federal government on a somewhat smaller total budget. It should be noted that Removals Australia is a special agency of the Australian national government that handles all aspects of household moves for all federal government departments as well as other levels of government.

Household goods management control activities do not always meet expectations

21.57 We noted that the extent of the activities conducted across the three departments is uneven. Furthermore, a number of activities are not being carried out at all. For example, quality control inspections and reweighs (described in paragraphs 21.83 – 21.89) are not being performed by the RCMP and PWGSC,

and the reweigh program at DND is performed only in a small number of locations and in a very limited way.

- 21.58 Exhibit 21.9 shows our analysis of the differing activities carried out by DND, the RCMP and PWGSC. Our own view is that these differences among departments in most cases call for one of two possible courses of action either decide that an activity is necessary and provide it consistently, or decide that it is not needed and eliminate it.
- Results of our review of best 21.59 practices suggest that not all of the activities provided are essential. In particular, quality control inspections and warehouse inspections are not performed by the vast majority of other organizations we examined. As one major public sector organization noted, relocated employees are their "quality control inspectors", through the mechanism of monitoring customer satisfaction and incorporating the results in the contracting process. Some of the more notable move management practices used by other organizations are described in Exhibit 21.10.
- 21.60 In addition to consolidating management activities in one department (see paragraph 21.50), there are possible benefits to be gained from centralizing geographically. A decision to no longer conduct quality control inspections and warehouse inspections would eliminate much of the need to keep staff at various locations throughout the country. The federal government is one of the few organizations that does not manage household goods removal services from a single location. People in the industry whom we interviewed would prefer to see administration and service delivery standardized across all departments, and management activities centralized to eliminate duplication, wherever practical,

and to better control the balance between price and service levels.

21.61 Some industry officials believe that aspects of the current structure are necessitated by the rules, regulations and reporting requirements involved in federal government moves. They argue that many of the steps in the process, such as warehouse inspections and attendance at employee homes, do not add sufficient value and have simply become entrenched over time. Industry officials maintain that some of these steps do not reflect common practice in the private sector and represent higher costs of compliance for industry.

21.62 A number of officials in the moving industry also indicated that because of high turnover of key federal government staff involved, the level of knowledge about industry practices has suffered. For example, the Chair of the IDC has changed yearly for the past few

years. If the federal government could find a way to control the frequency of staff rotation, it could increase expertise and provide continuity in management.

21.63 In our view, given the number of opportunities for improving the efficiency of move-management activities discussed in this section of the chapter, savings are possible in the order of \$1.5 million out of the \$5 million spent annually on the administration of household goods removal.

21.64 Industry officials noted that the cost of moving federal employees could be reduced further without adverse impact on service, in areas such as less storage in transit and the spreading of the workload more evenly during the busy summer months when the majority of moves understandably take place. DND and the RCMP believe that while this may be true,

Because of high turnover of key federal government staff involved, the level of knowledge about industry practices has suffered.

Expected Performance	Actual Performance			
	DND	RCMP	PWGSC	
Customer Survey Report:				
 distribution to employees 	Y	Y	Y	
– tabulation of results	N	N	Y	
Log registering complaints regarding the quality of service provided	X	N	N	
Inspections and audits of contractors' premises and records	N	N	N	
Quality control inspections (QCIs)	Y	N	N	
Liquidated damages	Υ .	X .	N	
Warehouse inspections	Y	Y	*	
Reweigh program	X	N	N	
Invoice verifications	Y	Y	Y	

Exhibit 21.9

Extent of Services Provided

Y: Performed as per contract expectations

N: Not being performed

X: Inconsistent performance

*: Performed by DND's employees

Source: 1996–97 tariff agreement between the Government of Canada and contractors for the provision of household goods removal services Industry officials noted that the cost of moving federal employees could be reduced further without adverse impact on service.

this kind of action could have a significant negative impact on morale and operations.

21.65 An improved performance measurement and reporting system is needed. We found that little performance data on cost and quality had been collected or used by management for 1996–97 due to computer system failures at DND. Early in our audit, the IDC informed us that developing a good performance information system was among its top priorities, and IDC actively participated in our benchmarking exercise as a way to make progress in improving its own performance measurement and reporting systems.

21.66 Senior management needs to consider carefully the future direction of the management of household goods removal services in the federal government. The management information systems in place are functioning only partially, and the Automated Move Management System is still in the pre-operations stage, as discussed in paragraph 21.52. Officials have postponed the transfer of the PWGSC responsibilities to DND that had been agreed to in 1995. Contracting out the management of the household goods removal function remains an option to consider.

Exhibit 21.10

Notable Move Management Practices Used by Organizations We Contacted

- Almost all organizations we contacted centralized household goods removal activities in a single department of the organization, and most co-ordinated other aspects of the relocation process, such as home sale, within that same unit.
- Only two of the organizations co-ordinated move management from geographically diverse locations.
- The majority of our participants allowed the employee the choice of carrier.
- Many of the organizations we spoke with found that allowing the employee and the carrier to negotiate a specific delivery date resulted in a greater level of customer satisfaction, and significantly less demand for storage in transit.
- One organization conducts a phone estimate with each employee in advance of the carrier estimate. This serves to provide a means of validating the carrier-provided estimate, and also serves to identify up front any unusual circumstances pertaining to the move. In another organization, employees are required to complete a detailed information package, in which they: list their furnishings and effects; provide a valuation of their goods being shipped; identify any special requirements; and indicate the dates on which they would like their goods both loaded and delivered.
- Several firms keep employee move "histories" key data on previous moves, including weight
 moved. These firms use this history as a means of validating the weight of the current move,
 since significant increases in weight may be an indication of weight bumping.
- One firm is making extensive use of the Internet as a means of communicating with the service
 providers, and has found that this represents a cost-effective and reliable means of keeping in
 touch with the carrier.
- Several other organizations, particularly third-party move-management firms, maintain
 management information systems more advanced than the federal government's, and were
 able to provide information tailored to specific client need.
- Several organizations conduct client satisfaction phone surveys with their employees within 48
 hours of move completion, and believe that this yields a high rate of return as well as more
 timely information.
- One organization has made provisions for the performance of on-site quality assurance inspections in locations away from its headquarters by having these inspections performed by independent third parties located in the vicinity of the shipment, at a cost of \$50 per inspection.

Source: OAG review of best practices

- 21.67 The Interdepartmental Committee should act to strengthen and improve the efficiency of the household goods move-management function, including:
- implementing an improved performance measurement and reporting system;
- making greater use of information technology for communicating with contractors, and for providing management with timely information;
- minimizing overlap in responsibilities among National Defence, the RCMP, and Public Works and Government Services Canada; and
- reconsidering the need for existing move-management activities such as inspections of warehouses and attendance at employees' homes.

Managing the Risk of Overcharging

21.68 The issue of "weight bumping" was raised by the Public Accounts
Committee as an area of specific concern to be addressed by the Auditor General.
The Committee made reference to the
28 November 1995 segment of the CBC television program "Marketplace", which raised the possibility that weigh scale tickets could be manipulated to the carrier's advantage.

The inherent risk of overcharging is high

- 21.69 We have identified four key factors that led us to the conclusion that the inherent risk of overcharging due to the possibility of weight manipulation is high. Those factors include compensation schemes for drivers, lowering of government tariff rates, a decrease in the number of government moves of household goods, and relaxation of certain regulations in the 1996–97 contract.
- 21.70 Compensation schemes for drivers. Many drivers are paid a significant percentage of the amount billed. The amount billed is mainly a function of the weight of the shipment. There are many opportunities for drivers who might wish to manipulate recorded weights to their advantage. Exhibit 21.11 lists some examples of some methods a driver could use to manipulate the gross weight shown on a weigh scale in a way that inflates the net weight of the household goods.
- 21.71 Lowering of government tariff rates. The decrease in government tariff rates in recent years can put pressure on a carrier's profit margin, increasing the inherent risk that weights may be manipulated for billing purposes. This is particularly true in situations where the carrier is significantly dependent on government business.

Four key factors led us to the conclusion that the inherent risk of overcharging due to the possibility of weight manipulation is high.

- When the tare weight is obtained, no individuals (movers) are in the truck; however, when the gross weight is obtained, individuals are in the truck.
- When the tare weight is obtained, have the fuel tanks empty; when the gross weight is
 obtained, have the fuel tanks full.
- Prior to obtaining the gross weight, add items to the truck that are not part of the government shipment being billed.
- When the tare weight is obtained, remove the spare tire; however, put it back on before obtaining the gross weight.
- Obtain a weigh scale ticket that is not preprinted and/or on which the weight identified is not printed by the computer.

Exhibit 21.11

Methods a Driver Could Use to Manipulate the Gross Weight Shown on a Weigh Scale

Source: United Van Lines (Canada) Ltd. Scale Report 1996

Departments are expected to have in place satisfactory financial controls and procedures.

The current system of invoice verification relies heavily on the validity of the weigh scale tickets.

Controls to mitigate the risk of overcharging may not be working as well as intended.

21.72 Decrease in the number of government moves of household goods.

The significant reduction in the number of government moves in recent years could also reduce the income earned from government moves, thus increasing the inherent risk of manipulation.

21.73 Relaxation of certain regulations in the 1996-97 contract. The government allowed some of the regulations to be relaxed in the 1996–97 Tariff Agreement. We noted that the 1996-97 Tariff Agreement did not specifically provide penalties for weight bumping, such as suspension of a carrier. As a result, there is less to deter drivers from manipulating the system. Also, we noted that a two-hour "window" was added for the driver to unload before contacting the destination base. This was introduced at the request of industry to minimize waiting. However, this could allow a driver who may wish to hide a weight bump to do so more easily.

21.74 It should be noted that under the present system the ultimate control over this risk resides with the integrity of the driver.

Controls to manage the risks are weak

21.75 In the course of reviewing a representative sample of move invoices to assess the possibility of overcharging, we noted a number of cases in which existing controls were not effective because they were not well designed, had been ignored or were not applied with sufficient rigor. While not significant individually, taken together they indicate that controls to mitigate the risk of overcharging may not be working as well as intended.

21.76 Under section 34 of the *Financial Administration Act* (FAA), the Deputy Minister or an authorized representative is responsible for ensuring "that the work

has been performed". In the movement of household goods this means, among a number of things, ensuring that the proper weight was reported by the driver and subsequently billed by the prime contractor. Departments are expected to have in place satisfactory financial controls and procedures to ensure that the invoices received from contractors are processed in accordance with their policies and procedures.

21.77 The main control procedures to ensure that the proper weight was billed are the verification of weight on invoices against weigh scale tickets, payment of no more than 110 percent of the estimated weight, billing for liquidated damages in cases where weight "errors" are detected, DND's reweigh program, and quality control inspections.

21.78 Weight scale tickets. The current system of invoice verification and the fulfilment of section 34 requirements rely heavily on the validity of the weigh scale tickets. According to DND, the "accuracy of the ticket is of prime concern.

Accordingly, tickets must be from a government-certified scale, completely filled out and be the original signed copy provided by the scale operator." In our view, information on weigh scale tickets is unfortunately not always a reliable, independent basis for payment.

21.79 Some examples of weaknesses in the way the controls are applied included a case where the driver submitted a weigh scale ticket with a gross weight that was used for billing purposes. However, the weigh scale operator's copy did not have a gross weight entered. As noted above, the amount of the payment is based on the weigh scale ticket. In one case, the weigh scale ticket was reported lost, and therefore no payment should have been made. However, the invoice was paid by the government based on an estimated

weight, without sufficient and independent verification that the work had been performed to the extent reported.

21.80 We also noted an instance where a photocopy of the ticket rather than the original was the only support for billing.

Payment of no more than 110 percent of the estimated weight. The departments attempt to limit their exposure to potential weight bumping by limiting the amount the government will pay in any one move to 110 percent of the original estimate of weight. However, our discussions with industry officials suggest that the tendency has been to overestimate the weight of shipments. We noted that one estimate was increased during a move at the request of the carrier without sufficient explanation or documentation to justify it. The 110 percent maximum payment rule has limited value as an effective control to minimize the risk of overcharging.

21.82 Liquidated damages in cases where discrepancies are detected. In years prior to 1996–97, "fines" ranging from \$10,000 to \$25,000 in the form of reduced business and suspensions could be imposed on contractors in cases where errors in weighing were detected by the government. However, in the 1996-97 Tariff Agreement this regulation was relaxed to change the fines and suspensions to a penalty-like system called "liquidated damages". Liquidated damages are fines levied on contractors for violating contract conditions. These fines are either flat amounts up to \$1,000, and/or certain amounts per day, item or pound of infraction. However, liquidated damages are not as severe as the previous penalties and therefore the deterrent effect is lessened. Furthermore, the lengthy process for establishing the damages reduces their impact. For the contract year 1996-97, a total of \$392,000 was

established as liquidated damages. As of 31 March 1997, \$22,000 had been collected. DND officials informed us that at that date a large portion of all identified liquidated damages had yet to be invoiced. Liquidated damages, therefore, have provided limited control against the risk of weight manipulation.

21.83 DND's reweigh program.

DND's reweigh program is another means to minimize the risk of weight bumping: a sample of shipments are reweighed under the supervision of a trained employee at destination. The objective is to verify that the driver's weigh scale ticket obtained at origin has not been manipulated.

21.84 On one reweigh we witnessed at the point of destination, the driver had not obtained weigh scale tickets at the origin. Therefore, the transportation agent was unable to assess whether a weight manipulation had occurred.

21.85 During the course of conducting our tests, we noted cases where individuals performing the reweigh did not appear to have sufficient and appropriate training and experience.

21.86 Our concern is that the existing reweigh program is also largely ineffective as a control against weight bumping, for two main reasons. First, the driver is not required to declare to the government the weight of the shipment at the point of origin to allow for a proper comparison with the result of the reweigh at destination. Second, the number of reweighs actually performed is insufficient: fewer than 0.2 percent of moves were reweighed and in many locations no reweighs were performed at all.

21.87 Quality control inspections to ensure that proper weight was established. Trucks are required to be weighed twice prior to leaving the city of

The existing reweigh program is largely ineffective as a control against weight bumping.

The aggregate weight billed exceeded our estimate of the aggregate weight of shipments moved.

Overcharging can also be due to excessive weight on account of unusual items included in shipments.

The perception remains that the potential for weight bumping still exists.

origin — once when empty and again after loading. DND's quality control inspections check for compliance with a number of the rules and regulations contained in the government tariff, including ensuring that the truck's fuel tanks are full. This is designed to minimize the risk that the driver can manipulate the weight of the shipment by refuelling after the original weighing. Although control inspections are conducted after the truck is loaded, they are not conducted between original weighing and loading. Quality control inspection is therefore limited as a control procedure because it addresses only one opportunity for manipulating weights.

21.88 Overcharging can also be due to excessive weight on account of unusual items included in shipments. We identified some apparently unusual, albeit "admissible" items, particularly in the case of shipments to overseas locations. We asked DND whether there is an opportunity here to save on costs. DND officials told us that the carriage of such items is consistent with policy and is not considered inappropriate.

21.89 None of the three departments involved in the supervision of moves critically reviews inventory listings for unusual or non-admissible items. In many cases, such items would not be detected because the listings are not always sufficiently descriptive of the nature and volumes of items carried.

Overcharging may have occurred

21.90 The sample of invoices we reviewed to assess the potential for "weight bumping" and higher-than-normal weight due to other reasons was limited to three of the four contractors. Although the fourth one indicated that it would be "co-operative and compliant", it also noted that it would agree to the

involvement of designated representatives, including members of our Office, but would "object to other industry members' involvement". Our audit procedures required that industry experts assist us in estimating the weight of specific items. Therefore, without involving other industry members, we would be unable to complete our audit procedures for the sample items related to that contractor. Accordingly, we did not examine that contractor's records and cannot draw any conclusion about the appropriateness of the weight recorded.

21.91 It is the position of PWGSC (the contracting authority) and DND that the government have full and free access to the records of all four contractors as it deems necessary to audit their invoices. Following our advice, the government has now obtained records from the fourth contractor; however, the government has decided not to analyze at this time the charges billed by this contractor.

21.92 Our sample of moves of household goods was selected from the population of moves between 1 April 1996 and 31 December 1996. The examination was not designed to reach conclusions about individual shipments but rather to identify bias, if any, in the aggregate amount of billed weight. The methodology for determining our estimate of the shipment weight on a per-item basis was developed in consultation with the van lines. The basis for estimation was a standard weight assigned for each type of item normally carried.

21.93 Based on the testing of a sample of invoices from three of the four contractors, on an aggregate basis the weight billed exceeded our estimate of the aggregate weight of shipments moved. The extent of the identified bias is statistically significant.

21.94 We discussed this observation with the three contractors. They agreed that using the methodology designed for this audit, the number and extent of variances in weight we found could reasonably lead to our overall conclusion at the aggregate level. However, the testing did not, and could not, demonstrate that there was any deliberate attempt by contractors or their agents to alter weights of shipments in order to receive higher payment from the Government of Canada. There is nonetheless a very real risk of recording excess weight, due either to weight manipulation or to the shipment of unusual items as previously described, given the high inherent risk and the weaknesses in the systems and controls in place as we have already noted. As a result, the perception remains that the potential for weight bumping still exists.

21.95 It should also be noted that the average weight per government move has increased by approximately 14 percent since 1994. The trend in the corporate sector is reportedly not as high. DND informed us that the increase in average weight can be attributed to several factors; given that an increasing number of its personnel live in private dwellings rather than military housing where major appliances are provided and basements are often unfinished, and that a higher proportion of personnel are married, it views the rise in shipment weights as reasonable and expected. There was no analytical information available to measure the impact of the above factors and we could not determine the extent to which the increase could be attributed to weight manipulation, if at all.

21.96 Removals Australia appears to avoid controversy about potential weight bumping. It obtains a detailed inventory from the relocating employee before calling for bids and, on the basis of that

inventory, estimates the volume of the household goods to be moved. Carriers are asked for a fixed-price bid based on this volume rather than on the shipped weight. If subsequently there are significant changes to the inventory list, the carrier may negotiate a price change with Removals Australia.

In our view, if the government continues to use weight as one criterion (along with distance) to determine price, it needs proper controls to ensure that the price it pays is the correct price, that is, based on the correct weight. Certain controls have been established that, as our audit has shown, have not been used correctly or adequately. It could be argued that, at a minimum, these controls should be applied more rigorously. However, the other important question is whether the controls can actually ensure correct weight, and consequently correct payment. There appear to be too many systemic problems and costly procedures associated with accurately measuring weight to use it as a basis for pricing moves.

21.98 All four van lines and the IDC agree on the need for a simple and auditable method for pricing moves of household goods — one that reduces the risk of error, the risk of weight bumping, and the cost of controls for both the government and the industry. Savings of \$100 per move in operating costs — \$1 million to \$2 million a year — are viewed by some industry officials as entirely realistic, provided there is no significant offsetting expense involved in the new basis for pricing moves.

21.99 We followed up with RCMP headquarters the specific allegation raised by the CBC television program "Marketplace" about the alleged overcharging for an RCMP move.

Officials informed us that the local police

There appear to be too many systemic problems and costly procedures associated with accurately measuring weight to use it as a basis for pricing moves.

All four van lines and the Interdepartmental Committee agree on the need for a simple and auditable method for pricing moves of household goods. The incidence of potential abuse and waste in the area of insurance claims is declining.

force where the incident occurred was still investigating. They further informed us that any decision to follow up on such matters rests with each divisional Commanding Officer but, while concerned about the impact of weight bumping, in their view the risk is not high.

21.100 Public Works and Government Services Canada, in consultation with the Interdepartmental Committee and the moving industry, should minimize the risk of overcharging due to weight bumping and strengthen the auditability of invoices from contractors.

Consideration should be given to introducing an alternative to the existing basis for pricing moves or, in the absence of workable alternatives, implementing a satisfactory reweigh program.

Insurance claims declined in 1995-96

21.101 Between April 1992 and March 1996, nearly one third of all relocated government employees received an insurance claim settlement.

21.102 On behalf of the IDC, PWGSC undertook a study in 1996 to address the Public Accounts Committee's concern about potential claims abuse. Our examination was limited to a review of the PWGSC working papers and report, which found that the average settlement amount for insurance claims from federal employees decreased by 26 percent — from \$762 in 1994–95 to \$558 in 1995–96 — although the average settlement, the frequency of claims and the number of items per claim remained higher than in the industry in general.

21.103 Moreover, the report found that the cost of insurance services had declined by about 15 percent between 1992–93 and 1996–97. The federal government's average cost per claim is higher at \$558

than that of a number of private sector organizations that reportedly average \$435.

Insurance claims abuse is not excessive

21.104 PWGSC also reported that of the claims filed by federal government employees, 19 percent are potentially exaggerated or fabricated in some manner. PWGSC concluded that this rate is similar to the private sector and that the cost of applying further controls would not likely be recovered through lower settlement amounts. Of these potentially abusive claims, on average only 37.5 percent of the amount claimed was actually paid.

21.105 It should be noted that these findings are based on a limited-scope study: an examination of claims for one van line, with the largest percentage of business for 1995–96. The other van lines to which the remaining business was allocated were not examined due to the cost and complexity of this review. We concluded that the incidence of potential abuse and waste in the area of insurance claims is declining. This conclusion was corroborated by senior industry officials.

Potential for Conflict of Interest

21.106 The Public Accounts Committee referred to "the potential existence of non-arm's-length relationships between the moving industry and the Interdepartmental Committee (IDC), the committee responsible for moving contracts."

21.107 We examined the risk associated with the relationship between the moving industry and officials of DND, the RCMP and PWGSC who form the IDC. We focussed on the allegations made in testimony before the Public Accounts Committee on 31 October 1995 stating that certain former government officials were in a conflict-of-interest situation. We

also reviewed the departments' compliance with the government's conflict-of-interest and post-employment policies and procedures. Our review as such was limited to assessing the potential for conflict of interest.

The risk of conflict of interest is changing

21.108 Based on the Treasury Board Conflict of Interest and Post Employment Code and the respective codes that apply to members of DND and the RCMP, we assessed the risk of potential conflict of interest on the part of public officials in relation to household moves. We looked at the opportunity for particular officials both to influence a decision and to obtain personal gain as a result. We considered the risk on the job and in post-employment.

21.109 There is always some risk that members of an organization can influence contract specifications in favour of established contractors, which potentially gives them an advantage after leaving employment. In post-employment the potential exists, particularly for former IDC members, to influence government officials to maintain contract specifications and operational requirements that favour established contractors. This risk is increased if former IDC members do not respect the government's post-employment codes.

21.110 The risk regarding IDC members relates mostly to potential impact on competitiveness. We noted that the Competition Bureau is examining the competitive aspects of the way the federal government purchases household goods removal services; the results were not available to us during our audit. The employment of several former senior DND officials by the moving industry has created concern in some quarters that fair

and open competition is affected. Partly in response to such concerns, the IDC requested that PWGSC take over the function of contracting with the moving industry. This recent event has changed the risk of potential conflict of interest between IDC officials and the household goods moving industry by establishing a separation of responsibilities. As PWGSC takes increased leadership in the contracting process, this risk should become lower.

21.111 PWGSC supply officers do not appear to have had a significant impact on defining operational requirements for household goods removal services, nor are we aware of any having taken employment with the moving industry after leaving the public sector.

21.112 Staff who administer individual moves in each IDC member department have potential opportunities for personal gain by influencing the quality, quantity and selection of quality control measures, including inspections. However, they do not have as much influence as members of the IDC to warrant preference in offers of employment from the moving industry.

21.113 Specific allegations. We reviewed the details of allegations of conflict of interest included in parliamentary records and in documents provided to us by the Public Accounts Committee. In total, we reviewed the circumstances of 14 former DND officials associated with the IDC, 11 of whom had chaired that committee or were subject to the government's codes. In addition to the requirements of the federal government's codes, we noted that in 1989 DND put in place Supplementary Compliance Measures pursuant to section 11 of the government's Conflict of Interest Code. DND had files for 8 of the 14 cases, which we reviewed. In the other 6 cases the conflict-of-interest code was not

There is always some risk that members of an organization can influence contract specifications in favour of established contractors.

applicable. We found that DND had properly applied its conflict-of-interest and post-employment code, including the Supplementary Compliance Measures, to the senior officials who took employment with the moving industry. Based on our review of the 8 cases, we found no evidence to support the concern that officials of DND were in a non-arm's-length relationship with the moving industry.

21.114 Representations from deputy ministers. As part of our approach we sought confirmations from the deputy ministers of DND, the RCMP, and PWGSC of actions they have taken in response to concerns of potential conflict of interest, and any knowledge they may have of such situations. Such representations are significant, in that they require the most senior departmental officials to ensure that codes of conduct are complied with. We therefore expected that they would disclose any information related to the subject under review that in their opinion warrants the attention of our Office. We received responses from all three departments confirming that their policies, practices and codes have been complied with, and stating that they were not aware of any conflict of interest between their officials and the moving industry.

There is scope to improve value for money in a number of areas.

21.115 On 16 July 1997 DND informed us that on 8 May it had received information from another agency suggesting that in 1994 a sensitive protected document that originated in that agency may not have been given appropriate care while in the possession of National Defence staff. The Department is still looking into this allegation and has indicated that it will advise us further.

21.116 Interviews with senior officials responsible for overseeing

conflict-of-interest policy. We met with the conflict-of-interest officials at DND, the RCMP, and PWGSC. We reviewed the details of their policies and their application to the circumstances under review. We confirmed with each of them the official representation sent to us.

21.117 In summary, we have determined that PWGSC, the RCMP and DND have applied the Conflict of Interest and Post-Employment Code appropriately in the situations that we reviewed. Any potential for conflict of interest, including non-arm's-length relationships between government officials and the household goods moving industry, is changing. This is partly attributable to the recent transfer of responsibility for contracting from the IDC, which is chaired by DND, to PWGSC. A final conclusion can be drawn only after the matter under review at DND is resolved.

Conclusion

21.118 There is scope to improve value for money in a number of areas.

21.119 The tariff paid by the government for household goods removals has been declining in recent years. Nevertheless, we have concluded that the contracting arrangements in place need strengthening. The business allocation formula used to distribute business among qualified contractors has proved to be brittle. Least cost and not best value has been the primary basis for allocation of business. Major stakeholders are seeking a better alternative to the current contracting arrangements.

21.120 The government's costs for managing household goods removals have not been falling commensurate with the significant decline in the volume of moves. There are several areas where changes in management and

operating policies could result in improved cost and quality of service.

21.121 The government has identified potential opportunities to save some \$1.5 million yearly by improving efficiency in managing the services. Enhanced use of information technology, centralization, simplification of rules and regulations and more attention to customer satisfaction are areas that need action.

21.122 The management of the risk of overcharging due to "weight bumping" and the carriage of unusual items needs to be strengthened. The inherent risk in this area is high; the systems and controls in place to prevent abuse are not working as intended. While it is extremely difficult to determine the precise nature and extent of overcharging that may be occurring, our analysis points to a systemic upward bias in the aggregate weight billed in 1996–97. The government recognizes the problem and has indicated that it will seek to create workable solutions with all stakeholders in consultation with industry. Further, savings of \$1 million to \$2 million in operating costs can be achieved if a basis for pricing moves is found that eliminates the requirement for weighing shipments.

21.123 The potential for claims abuse is not excessive. Finally, the potential for non-arm's-length relationships between the moving industry and the IDC remains, but the risk is changing.

Response from the Department of
National Defence, Public Works and
Government Services Canada and the
Royal Canadian Mounted Police: The
taxpayer receives good value for its money
and we are pleased that the Office of the
Auditor General recognizes that we
receive significantly lower prices for
household goods removal services.
Nevertheless, the OAG's recommendation

to place more emphasis on employee satisfaction may have merit. Where feasible and cost-effective, it is our intention to place greater emphasis on employee satisfaction as a factor in the performance measurement framework.

This audit found no evidence of weight bumping. However, we are committed to mitigating this risk and continue to strengthen controls through such measures as increased inspections and reweighs.

The report observes that the average weight per government move is increasing. The government's average weight per move is still less than half of the entitlement. This increase is a result of socio-economic factors and of entitlement and policy rather than transportation pricing, contracting and controls.

The report also observes that the potential risk of non-arm's-length relationships between the moving industry and government employees is changing. The management and contracting responsibilities for household goods removal services are now separated. In addition, the OAG has observed that Treasury Board's Conflict of Interest and Post-Employment Code policies are being appropriately applied. These two factors have reduced the risk of non-arm's-length relationships.

We continually seek to improve how we administer the household goods removal business and have worked closely with the OAG audit team to that end. Outlined below is the plan to achieve the following objectives:

- strengthen the contract framework
- improve management efficiencies
- pursue potential additional savings

A. Strengthen the Contract Framework

Major changes to the contract framework were undertaken in response to Internal Audit and Bureau of Competition recommendations to increase competitiveness, permit new entrants, and reduce the regulations of the industry. These fundamental changes have directly contributed to achieving one of the lowest tariffs in Canada for the past two contract terms. Nevertheless, we agree that the contracting framework can be strengthened. Notably, analysis and alternatives to the bid-matching provisions, opportunities to provide greater emphasis on employee satisfaction in contractor selection/business share allocation, innovation and alternatives to the basis of payment will be sought.

The complexities of contracting for household goods removal services are recognized and the government encourages competition. It is our intention, together with the major stakeholders in the government and the industry, to evaluate potential solutions in a more detailed cost-and-benefit assessment, beginning this fall. It is our intent to examine the impact on rates, in particular in remote and low-volume areas, as well as the increase/decrease of service levels provided to government employees. In addition, any recommendations from the Bureau of Competition will be incorporated into the analysis where feasible.

The current contract expires 31 March 1999. This will provide us sufficient time to assess options with the aim of incorporating changes into the Statement of Work for the next contract.

In the interim, steps have already been taken to strengthen control procedures to reduce the risks associated with the use of weigh scale tickets until a better alternative is found. The reweigh program has been strengthened by increasing the frequency and the RCMP has begun conducting Quality Control Inspections (QCIs). As well, liquidated damages for weigh scale ticket irregularities have been instituted in the 1997–99 contract. Discussions have also taken place with a third-party move-management firm to provide a proposal for an alternative basis

of payment for the government's consideration.

B. Improve Management Efficiencies

Currently, based on a Senior Review Board decision, the government has put in place a plan to centralize the management function of household goods removal services and to improve its automation tools. The implementation of the Automated Move Management System (AMMS), scheduled for implementation in April 1999, will result in a marked advance for government to effectively manage household goods removal services and increase efficiencies. The transfer of PWGSC/Central Removal Service (CRS) is planned to coincide with the implementation of AMMS. The AMMS project is currently funded, a team has been established, and the project is progressing on schedule. Discussions have begun with the RCMP to also transfer portions of its responsibilities to DND as an initiative to further eliminate overlaps.

Coincident with progressing on the AMMS project and the development of a PWGSC/CRS transfer implementation plan, an assessment is planned to validate that in-house alternatives remain more cost-effective than contracting the move-management function to the private sector. In addition, the rationale supporting the transfer of PWGSC/CRS to DND will be revisited. These activities are planned to be completed this fall.

The Furniture and Effects Administrative System (FEAS) program currently used to support the management of household goods within DND remains problematic. However, the program is largely functional, with the exception of electronic communication links with contractors, and it is capable of providing some management reports. As a consequence, an assessment is being prepared to determine the possibility of DND using the PWGSC/CRS computer system. The performance measurement project is also nearing completion and will be further

enhanced with the implementation of AMMS.

C. Pursue Potential Additional Savings

The OAG suggests additional savings can be achieved through further reductions in Storage in Transit (SIT), spreading moves over larger periods of time and cancelling QCIs and warehouse inspections, together with the creation of an alternative to the current basis of payment. The potential for reducing costs for both the government and for the industry are recognized; however, it must be appreciated that these are only marginal costs, which again suggests that the government is receiving good value for money (i.e. potential savings of \$1.5 million in industry operating costs if a mechanism other than scales is used and if the alternative does not add any other costs). The main cost to government remains that of the tariff and any changes made must ensure that the government continues to obtain a competitive tariff.

With respect to reducing SIT and spreading moves over a larger period of time, significant gains have already been made over the past several years in these areas. Additional substantive gains would not be easily achievable without significant, potentially negative, impacts on morale and could pose operational limitations. This matter will be reviewed.

The need for QCIs, warehouse inspections and establishing an alternative basis of payment can be addressed only within the contract framework. As such, these items will form part of the government's plan to review the contract framework described above.

Within DND, the Cost Move Steering Committee has been re-instituted with its first meeting planned for this fall. Potential options for further reducing SIT and spreading moves is a planned discussion item.



About the Audit

Objectives

The overall audit objective was to assess whether there is scope to improve value for money from the arrangements in place to procure and manage household goods removal services — more specifically, whether:

- present contracting arrangements provide reasonable cost and quality of service and a fair and competitive process;
- the government's management of removal services is economical and efficient; and
- satisfactory controls are in place to guard against overcharging through weight bumping, the potential for excessive insurance claims, and conflict of interest.

Scope

Our audit focussed on those government household goods moves that are the responsibility of the Interdepartmental Committee on Household Goods Removal (IDC). These mainly cover:

- moves handled by the Removal Section of DND and the RCMP;
- those handled by the Central Removal Service of PWGSC (a common service organization); and
- overseas moves that are the responsibility of DND.

Excluded from the scope were domestic moves that are the responsibility of the House of Commons and overseas moves by the Department of Foreign Affairs and International Trade (DFAIT). Also, we did not audit the decision to relocate an employee.

Criteria

The audit criteria were built on the foundation for government contracting as it appears in the Treasury Board Contracting Policy, which points to, among others, the following:

- 1. The objective of government procurement contracting is to acquire goods and services and to carry out construction in a manner that enhances access, competition and fairness and results in best value or, if appropriate, the optimal balance of overall benefits to the Crown and the Canadian people.
- 2. Government contracting shall be conducted in a manner that will:
 - (a) stand the test of public scrutiny in matters of prudence and probity, facilitate access, encourage competition, and reflect fairness in the spending of public funds;
 - (b) ensure the pre-eminence of operational requirements.

In addition, Treasury Board, in its Comptrollership Policy, requires Departments to establish and document internal policies outlining the extent of accounts verification required, to:

- (a) certify that the work has been performed, the goods supplied or the services rendered or
- (b) in the case of other payment, the payee is entitled to or eligible for the payment.

This Policy also requires that the accounts verification process be audited by the departmental internal audit group.

Approach

We pursued several lines of audit inquiry to answer the following questions:

First, has the contracting arrangement in place resulted in a reasonable cost and quality of service and is the process fair and open?

Second, are the accounts verification processes and related controls operating satisfactorily to guard against overcharging resulting from weight bumping, excessive insurance claims and non-arm's-length transactions, if any, between officials of the IDC and the moving industry?

Third, does the actual cost of the household goods management function reflect the government's own expectations in terms of cost and efficiency, and are the activities carried out as required?

In addition to the above, we benchmarked the government's costs and quality of service with several other organizations that move significant numbers of employees. We also identified best practices in these organizations that could be beneficial to the federal government. Finally, we examined the roles and responsibilities of the key organizations involved with household goods removal to determine whether any significant weaknesses in the government's performance could be attributed to gaps, if any, in accountability.

Our approach was to first determine what actions, if any, have been taken by the government to address concerns that were brought to the attention of the Standing Committee on Public Accounts in 1995. Next, we assessed the nature and extent of actions taken by the government since 1995. Finally, we conducted such tests and procedures as we considered appropriate to assess the systems in place to prevent waste and abuse in the stated areas of concern to the Public Accounts Committee.

We did not conduct an investigation to determine the extent of fraud, abuse or conflict of interest; rather, we examined the government's management practices to assess the potential for such behaviour.

Household goods relocation has been the subject of internal audit and reviews on several occasions; to the extent that the findings of these studies remain relevant, we took them into account. For example, a 1990 internal audit at DND that examined Military Move Claims dealt with important aspects of the relocation of military personnel. Between 1991 and 1994, three studies were initiated by the IDC to analyze the cost of managing household goods removal services and to identify potential savings. In 1996, a review of the 1996–97 process for soliciting and contracting for household goods moving services was carried out by the Audit and Review Branch of PWGSC. There were no such examinations relating to the accounts verification process.

Audit Team

Manfred Kuhnapfel Neil Maxwell Jacques Marquis Martha Lywak Anne Hardy

For information, please contact Vinod Sahgal, the responsible auditor.

Appendix

Exchange of Correspondence between the Public Accounts Committee Chair and the Auditor General

Letter from the PAC to the OAG, June 20, 1996

Ottawa, 20 June 1996

Mr. Denis Desautels Auditor General of Canada Office of the Auditor General of Canada 240 Sparks Street, 11th Floor Ottawa, Ontario K1A 0G6

Dear Mr. Desautels.

As you may be aware, the Standing Committee on Public Accounts has developed an interest in the manner in which the federal government of Canada arranges the relocation of household goods of its employees who have been transferred from one location to another.

According to a 1994 estimate, the costs of the moving contracts alone for relocating federal employees was between \$100 and \$120 million. During the same period, it was estimated that the federal government accounted for 30 to 40 percent of the 80,000 to 100,000 total household moves handled by the moving industry in Canada. These data indicate that these relocations represent a considerable cost to federal treasury and to the taxpayers of Canada They also suggest that actions by the federal government in this area have an impact on the moving services industry as a whole and on the rates paid by individual citizens to have their belongings relocated.

The Committee has studied the matter and has determined that further investigation is warranted. Therefore, as a consequence of the need for further study and of the costs involved in relocating the household goods of government employees, the Standing Committee on Public Accounts is formally requesting that you and your Office examine and report on this aspect of government expenditure. As part of your audit, we also request that you investigate the following elements associated with federal government household goods removal services:

- the potential of claims abuse or "weight bumping," and, in particular, allegations raised during a November 28 1995 segment of the CBC television program "Marketplace";
- the systems in place to prevent waste and abuse, either by moving companies or by federal government employees;
- the number and cost of both military and civilian personnel employed by the government to manage household goods removals;
- the potential existence of non-arm's-length relationships between the moving industry and the Interdepartmental Committee (IDC), the committee responsible for moving contracts; and
- the operation of the new business allocation formula, including the criteria such as the infrastructure in place employed to select winning bidders, used by the IDC to award moving contracts.

The Standing Committee would also appreciate receiving your suggestions on the steps that could be taken in order to reduce the costs to government and taxpayers of household goods removal services.

Because the issue is serious and the costs considerable, the Standing Committee asks that you give this matter your immediate attention. The Committee's research staff is prepared to provide any relevant documents that have been acquired in order to assist in the investigation.

In closing, and on behalf of the Committee, I would like to thank you and your Office for the assistance provided to the Committee during the past session of Parliament.

Yours sincerely,

Original Signed by Michel Guimond, MP Chairman

Letter from the OAG to the PAC, July 8, 1996

240 Sparks Street Ottawa, Ontario K1A 0A6

8 July 1996

Mr. Michel Guimond, MP Chairman Standing Committee on Public Accounts 726 Avenue Royale Beauport, Québec J1E 1Z4

Dear Mr. Guimond:

Thank you for your letter of 20 June regarding your Committee's request that my Office examine and report on federal government household goods removal services. I am pleased to inform you that we have considered the Committee's request carefully and have decided to conduct a value-for-money audit of household goods removal services including the specific points in your letter.

I have assigned a high priority to the completion of this audit. Accordingly, we will reassess other planned audit priorities in order to report this audit to Parliament at the earliest opportunity. Given the scope of matters expressed in your letter, I plan to report the results of our audit in the first periodic report of 1997 scheduled for tabling in April or May. Meeting this tentative reporting date will depend on the complexity and difficulty of the audit and of dealing with many government departments. Audit work of this complexity requires a minimum of six months field work in addition to planning, report writing and publishing time.

I trust that this will fully meet the Committee's expectations. Should you require clarification on the scope and timing of this audit or on any other matter of interest to the Committee, please do not hesitate to call me.

I would like to take this opportunity to thank the Committee for its interest in the work of the Office over the past year. Your hearings and reports play an important role in government accountability.

Yours sincerely,

Original Signed by L. Denis Desautels, FCA

cc: Bernard Fournier



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April 1997

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